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Dealing with Iran
PAGES 12 AND 22–24

Is the economy turning?
PAGE 29

Airbus and bribery
PAGES 55–58

A SURVEY OF THE NORDIC COUNTRIES
AFTER PAGE 50

Extinction of the car giants

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POLITICS THIS WEEK

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OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

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Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
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Mobile Edition
RSS Feeds

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Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Extinction of the car giants
Why America's car industry is an endangered species ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Carmakers
Extinction of the car giants

Israel and the Palestinians
Dousing the candle

Iran's nuclear ambitions
Time to call a halt

Britain and the euro
Can they be serious?

Congo's war
Africa's open wound

Directors' insurance
Double indemnity

Letters

On weapons of mass destruction, baseball, football, Hong Kong, Islam, the EU constitution, military intervention, Moore's law

Special Report

Dealing with Iran
Next on the list?

Iran's nuclear programme
Fissionable

United States

The economy
Poised for growth?

The labour market
Make mine a latte

Medicare reform
Pre-emptive surrender

Lawsuits
Erin Brockovich fights again

Head to head in the Senate
A fuss over filibusters

Illinois politics
Business as usual?

Lexington
St George and the dragon's hoard

The Americas

Politics in Mexico
Fox puts a presidential face on some worrying electoral computations

The Dominican Republic
Swindled

Venezuela's economy
On the breadline

Brazilian electricity
Lighting a candle

Asia

Japan and South Korea
Closing ranks

Culture in the Koreas
The silver screen of peace

Myanmar
Dialogue of the deaf

Afghanistan
A question of resolve

Kazakhstan
Waiting to be rich

India
An echo of terrorism

Dowry inflation

Previous print editions
Jun 7th 2003
May 31st 2003
May 24th 2003
May 17th 2003
May 10th 2003
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A midsummer night's dream
Edging closer
Borderless
Mix and match
Sharp tongues
Krybbe to grav
From Vikings to peacemongers
Identity changes
Acknowledgments
Offer to readers

Business

Ford's troubles
One hell of a birthday, Bill

Investing in Angola
Into Africa

Japanese innovation
Redesigned

Women and MBAs
Men's work?

Oracle's bid for PeopleSoft
The next software battle

Face value
Clean Breen

Special Report

Aircraft and bribery
Airbus's secret past

Finance & Economics

Bond markets
The temptations of yield

Bank branding
Name theory

Freddie Mac
Trouble at home

Exchanges
Banks beaten

Japan's economy
Black ink

Japanese finance
Unhappy returns

Banking in China
Bad habits

Central European currencies
Inelastic bands

Economics focus
Germany's euro test

Science & Technology

Fetal origins of adult disease
The child is father to the patient

Blood transfusion
Cleaning up

Books & Arts

Wagner in Russia
Ringing in the century

A suitable price

Middle East & Africa

Israel and the Palestinians
And it all goes up in flames

The Kurds in northern Iraq
What's happened to our cash?

Communists v clerics in Iraq
Battle of the beards

Peacekeeping in Congo
Is protection a mirage?

Zimbabwean arrests
At the receiving end of Mugabe's punch

Kenya's lost general
A case of mistaken identity

Europe

Poland and the European Union
Back into the fold

Britain and the euro
What a pity. What a relief

NATO
The alliance tries to strike back

Jürgen Möllemann
A mysterious death

Protest in France
A government assailed

Turkey's army
Is it a waning influence?

Charlemagne
The great debate

Britain

Britain and the euro
No again

History lesson
What if Britain had joined in 1999?

Football finances
Beckonomics

Wedding costs
For poorer

Occupational pensions
Copycat

Scottish Enterprise
Wrong target

Criminal justice
Police and polis

Sexually transmitted diseases
Out of Africa

Bagehot
Body double

Thailand's transvestites and transexuals
Skirting pain

The Suez Canal
A cut in the dunes

Jean-Marie Messier
Himself

New American fiction
In over his head

George Orwell
The master's voice

Obituary

Felix de Weldon

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Ireland

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Biotech companies

Emerging-Market Indicators

Overview

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Economy

Financial markets

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Politics this week

Jun 12th 2003
From The Economist print edition

Losing the way

AP

The Middle Eastern road map crashed into huge road blocks. A **suicide bomber** blew up a bus full of people in Jerusalem, killing 16. In a series of strikes, Israel killed at least 14 people in Gaza, including five Hamas men. The day before, Israel had tried to assassinate Abdel-Aziz Rantisi, Hamas's top political leader. He escaped, but Hamas vowed revenge. Earlier, militants had killed five Israeli soldiers.

See article: Back to earth

After intense fighting between rebel forces and Charles Taylor's regime in the suburbs of Monrovia, **Liberia's** capital, the two sides agreed to a ceasefire, paving the way for peace talks in neighbouring Ghana to resume. Foreign nationals were evacuated from Monrovia by French military helicopters.

An attempted coup against **Mauritania's** president, Maaouya Sid Ahmed Ould Taya, was put down after heavy fighting in the centre of Nouakchott, the capital. The president recently cracked down on suspected Islamists; the rebels are said to be dissident members of the army.

French soldiers started to arrive in **Bunia**, the capital of a region in north-eastern Congo that has been torn by savage tribal fighting. The French will provide most of the troops for a 1,400-strong peacemaking force with a weak mandate.

See article: Peacekeeping in Congo

After the protests in Harare last week, **Morgan Tsvangirai**, the leader of the opposition Movement for Democratic Change, was arrested on charges of treason and held in prison. Robert Mugabe, who is 79, dismissed talk of his possible retirement, saying it would be “nonsensical”.

See article: Zimbabwean arrests

Uganda's president dismissed his army commander, Major-General **James Kazini**. The general had been under investigation after allegations, by the United Nations, of plundering during Uganda's occupation of parts of Congo. The general said he was “only being flexible”.

Powell heads south

In a fence-mending visit to Latin America, Colin Powell, America's Secretary of State, called on the **Organisation of American States** to take a more active stance against Cuba's communist government. Brazil and others were cool to the idea.

In **Peru**, over 70 workers employed at the Camisea natural-gas project were kidnapped, apparently by the Shining Path, a formerly powerful Maoist terrorist group. They were later released. It was not clear whether a ransom was paid.

In an extraordinary session of **Venezuela's** National Assembly held in a park, legislators loyal to President Hugo Chávez approved rule changes to prevent the opposition blocking bills. But they were unable to ratify the changes at a full session.

See article: Venezuela's economy

Trouble up North

North Korea continued its nuclear “diplomacy”, saying it needed nuclear weapons to counter America's “hostile policy”, but also to cut its armed forces and put more cash into its economy. Colin Powell, America's secretary of state, repeated that a peaceful solution was being sought to the North's nuclear problem. Australia said it was working with Japan and America to stop the North exporting drugs and missile parts.

See article: More nuclear threats

Aung San Suu Kyi, Myanmar's democracy leader, is “well and in good spirits”, said Razali Ismail, a United Nations envoy who visited her in “protective custody”. Miss Suu Kyi was detained by the military government after an attack on her and her supporters in the north of the country.

See article: Stalemate in Myanmar

As Indonesia's military offensive against separatists in its western province of **Aceh** entered its fourth week, the Red Cross said it had taken 151 bodies to hospitals and morgues. All were in civilian clothes. The army said 172 separatist fighters and 21 soldiers had been killed.

A three-month dig at Ayodhya in **India** has failed to find evidence of an ancient Hindu temple under the ruins of a mosque.

China's Three Gorges reservoir, part of the world's largest water-control scheme, was reported to be deep enough for turbines in its dam to start generating power and for ships to resume sailing on the Yangzi.

Reuters

Poll of Poles

The **Poles** voted overwhelmingly to join the European Union, with 77% saying yes in a turnout of about 59%.

See article: Poland votes for the EU

The EU's **farm ministers** began discussing reform of their system of agricultural subsidies, which is vital if a new round of world-trade negotiations is to succeed. There were reports that France had persuaded Germany to join the opposition to radical reform.

See article: Digging for victory?

Another wave of strikes and demonstrations hit **France** on June 10th in protest against a proposed pension reform. Police used water cannon to disperse rioters outside the National Assembly, where the bill was in its first reading, and arrested about 60 of over 300 demonstrators who disrupted a performance at the National Opera. Next day, protesters tried to force their way into the headquarters of the ruling UMP party.

See article: Violence in France

Police in France arrested a German alleged to be a leader of **al-Qaeda** who was involved in the attacks in America on September 11th 2001.

Austria's centre-right chancellor, Wolfgang Schüssel, forced a reform of the pensions system through parliament, but his coalition with the far-right Freedom Party was shaken.

Silvio Berlusconi's ruling right-wing coalition did poorly in a second round of local elections in **Italy**, losing, among others, the cities of Trieste and Brescia.

The non-violent **Basque** Nationalist Party, which easily won recent local elections, was at loggerheads with the government in Madrid, when it said it would defy a decision by Spain's Supreme Court to expel members of the Basque regional assembly who belong to a banned party that is the voice of the separatist terrorist group, ETA.

Turkey's government was poised, at last, to enact a clutch of human-rights and other reforms, despite the reluctance of its influential generals to endorse them.

See article: Turkey's generals

Old news

AP

The oldest **fossils** of *Homo sapiens* yet discovered were reported in *Nature*. Three partial skulls were found in Ethiopia. They date back around 160,000 years.

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Economist.com BUSINESS
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Business this week

Jun 12th 2003
From The Economist print edition

Playing hardball

Oracle, the world's second-largest software firm, launched a hostile bid for **PeopleSoft** worth some $5.1 billion. The offer for its rival came just days after PeopleSoft had launched a $1.6 billion bid for a competitor, **J.D. Edwards**. PeopleSoft reacted frostily; some suspected a tactic to disrupt the earlier deal.

See article: Oracle's bid for PeopleSoft

Telecom Italia is to sell its majority slice of **Seat Pagine Gialle** for about *euro*5.7 billion ($6.7 billion). The directories business will go to a group of British and Italian investors.

More businesses were caught by the spread of SARS. **Nokia** said that it would not meet forecasts for sales growth of handsets in the second quarter, particularly in China, because of the disease. But it added that it still expected 10% growth for the year. **Motorola** also cut profit forecasts.

America's **United Technologies**, which makes lifts, jet engines, helicopters and air-conditioners, offered $1 billion for **Chubb**, one of the world's leading security-equipment firms. The British firm recently said that profits would suffer this year. Inevitably, SARS was held partly reponsible.

Texas Instruments, an American technology firm, gave warning that its sales and profits in the second quarter would suffer because of SARS.

German consumers were at last granted the privilege of shopping after four o'clock on Saturday afternoon, after trading laws introduced in the 1950s to protect small retailers were relaxed. Until 1996, shops were forced to shut at 2pm. Predictably, trade unions and churches complained.

See article: German shopping hours

Dirty Mac?

The Securities and Exchange Commission began a probe of **Freddie Mac** two days after the government-backed mortgage lender had fired its chief operating officer, David Glenn, over concerns about his “co-operation and candour” with an investigation of accounting errors. Freddie Mac also announced the departures of its chief executive and chief financial officer. A criminal investigation is also under way.

See article: A troubled mortgage giant

Sam Waksal, founder and former chief executive of **ImClone Systems**, was sentenced to seven years in jail for insider dealing. He will also pay $4.3m in fines and back taxes. Martha Stewart, America's home-improvement guru, was recently charged with similar offences.

Xerox's shares plunged last year over revelations of improper accounting in the late 1990s. Investors will now pay directly as well. Six former executives will hand over just $3m of penalties totalling $22m levied by America's SEC to settle the case. Unlucky shareholders will foot the rest of the bill, and legal costs too.

Two reports into the huge financial scandal that bankrupted **WorldCom** blamed Bernie Ebbers, the telecoms company's former boss, and a coterie of top executives, for “financial gimmickry, deception and

outright fraud” that brought about the demise of the telecoms giant. Two current executives resigned from the firm (now renamed MCI).

Out of the blue

JetBlue Airways placed an order for 100 planes from Brazil's **Embraer** worth some $3 billion; it is hoping to exploit new markets while its competitors suffer. The profitable American low-cost carrier also took an option for another 100 aircraft. Embraer was also reported to be working with Lockheed Martin on a new contract for a plane for the United States Army.

Lockheed Martin is suing its arch-rival, **Boeing**, and three former employees, alleging that the aerospace giant used private Lockheed documents to help win a government rocket contract in 1998. Boeing took out full-page adverts in America's biggest papers to distance itself from the actions of a few bad apples.

See article: Aircraft and bribery

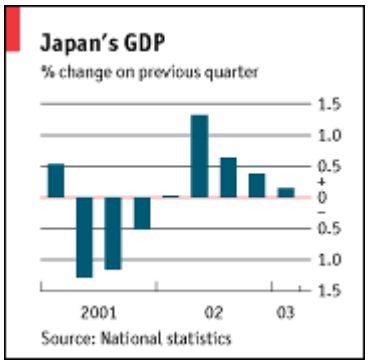
Reports of a “casual offer” over dinner of a close union incensed **Thales**. The French defence contractor denied any such approach to **BAE Systems**; the couple have long enjoyed a complicated relationship. The British defence firm demurred, and said that anyway its heart was set on a liaison with a big American.

Winterthur, Credit Suisse's insurance arm, announced the sale of **Churchill**, a British insurance company, to **Royal Bank of Scotland** for £1.1 billion ($1.8 billion). The British bank will add Churchill to Direct Line, its insurance subsidiary, to create the country's third-biggest general insurer.

A little better

Japan's economy grew by 0.1% in the first quarter rather than standing still, according to revised figures. This better news sent the Nikkei 225 to a six-month high. But celebrations could be premature, since the economy is still expected to contract in the second quarter; and deflation continues.

See article: Profits turn upwards



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Carmakers

Extinction of the car giants

Jun 12th 2003
From The Economist print edition

Why America's car industry is an endangered species

Get article background

MOTOWN is celebrating. One hundred years ago Henry Ford set up in business, and America's love affair with the automobile began. Ford is staging a party that would not have disgraced Jay Gatsby. And why not? The American car market has been roaring, with annual vehicle sales over 16m. It could be close to 20m in a decade's time, with another 26m young Americans clamouring for their first set of wheels.

Yet the ride is not going to be smooth: it will be more like cruising in a Ford Thunderbird while ignoring a nasty rumble from its mighty V8 engine. For all the signs are that things are going badly awry in Detroit. Unless something changes, the industry could go broke—with Ford, the most troubled of the big three carmakers, leading the way (see article). The 100th birthday party could swiftly be followed by a wake.

Been there, done that

This quintessential American industry has, admittedly, been written off before, only to bounce back. Chrysler entered the 1980s thanks to a federal bail-out; Ford narrowly escaped bankruptcy around the same time. Washington also came to the industry's aid with restrictions on Japanese imports. Even so, Chrysler nearly came to grief again in the early 1990s, before it was sold to Daimler-Benz. In 1991, the combined losses of the big three topped $7 billion. General Motors (GM) was said to be within an hour of going bust in 1992, with its bosses staring at the fax machine as they waited for a credit-rating downgrade that would have pushed the company over the edge. The downgrade never came, and GM recovered.

Over the 1990s, modernisation and imitation of Japanese techniques helped to raise Detroit's game. But the saviour of the industry was America's growing appetite for sport utility vehicles (SUVs), minivans and pick-up trucks. For years these chunky vehicles have enjoyed such success that Detroit has made most of its profits from them. Today they account for every other passenger vehicle sold in America. Competing Japanese products, where they existed, faced import tariffs. But now Toyota, Nissan and Honda have developed their own competitors in this market—and they are making them where it matters, in America's southern states, far from the citadel of union power that is Detroit. Also in the 1990s, the industry benefited from a booming stockmarket that lightened the car makers' growing pension burden as they shed workers in an effort to become more efficient. There is no sign of any such

deus ex machina now.

The industry's leaders, as ever, cast the blame at a weak economy. GM's boss, Rick Wagoner, reacted to September 11th by launching discounts and interest-free financing to “keep America rolling”. Almost two years later the discounts are still there, and he cannot see them stopping without a “significant” improvement in the economy. He pins hopes for the future on America's growing population and China's rising wealth, which is at last igniting demand. But neither American babies nor Chinese yuppies may come in time to rescue Detroit. Nor will a resurgent American economy.

America's car industry is in a trap. It has one-fifth more capacity than it needs. Japan's big three (Toyota, Nissan and Honda) now make a full range of models in America, and manage to sell them without deep discounts. The reaction of any normal industry to such overcapacity would be to shrink, paying attention to profits not sales. But Detroit is not normal. Its labour contracts with the unions restrict its ability to close factories quickly. Jack Smith, a former chairman of GM, used to complain that he would have to wait until his workers retired to get numbers down and make factories more efficient.

Worse, retirement now brings its own peril, as every retiree adds to the car companies' growing pension burden. GM already has a pension-fund shortfall of $19 billion, as big as its market capitalisation. Add the health-care liabilities of both employees and pensioners, plus the presence of the United Auto Workers (UAW) union, and Detroit is at a huge competitive disadvantage to its Japanese competitors, with their younger, non-unionised workforces. GM, which has two-and-a-half pensioners for every employee, reckons pensions and health-care benefits add $1,000 to the cost of each car it makes. Cuts in the workforce make the burden still greater. In Detroit's circumstances, in short, downsizing cannot deliver results.

In the past two years, the federal government has come to the rescue of farming, steel and airlines through subsidies and import barriers. It may be just a matter of time before a big carmaker considers using America's Chapter 11 bankruptcy law to shed its pension liabilities, as several steel companies and airlines have already done. When that happens the federal insurance agency picks up much of the tab. It is, however, cash-strapped already. Moreover, the examples of steel and airlines, with their repeated bankruptcies, suggest that federal bail-outs cannot solve an industry's fundamental problems.

The figures are bleak. Instead of the $2 billion operating profit it once forecast, Chrysler has given warning of a $1.2 billion operating loss in the second quarter. Ford and GM are expected soon to issue similar bleak warnings. Once the Ford birthday bash is over, Detroit will start negotiating a new three-year contract with the UAW. This will be tough, as it will include the carmakers' plans to close some factories—and they already admit that planned closures may not be enough.

Delayed impact

Can Detroit escape the grim reaper a third time? The odds look poor. In the past seven years Detroit's share of the American market has slid from 73% to barely 63%. If SUVs, pick-ups and the like are excluded, the big three's share of the passenger-car market is already under half. The backlash against gas-guzzling vehicles can only be bad for Detroit. And the Japanese and German car companies have begun to produce models that compete head-on with such American icons as Ford's F-150 truck. If the Japanese repeat their success with smaller cars, the big three's last profitable redoubt will be overrun. The extinction of America's car giants is no longer just a bad dream: it is coming closer to reality.

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Israel and the Palestinians

Dousing the candle

Jun 12th 2003
From The Economist print edition

So much for the good beginning

Reuters

Get article background

SELDOM has a glimmer darkened so quickly. Last week, George Bush's personal commitment to a Middle Eastern peace seemed to give Israeli and Palestinian peace-seekers at least a chance to try again. This week, as a bomber slaughtered a busful of people in Jerusalem, that chance looks dead.

The descent to blood started days after the Aqaba summit, with the weekend's concerted attack by militants from three Palestinian groups—Hamas, Islamic Jihad and al-Aqsa—which killed four Israeli soldiers in Gaza. In reply came Israel's attempted assassination of Abdel-Aziz Rantisi, Hamas's top political leader. For that, Hamas vowed revenge: hence the bomb, and at least 16 people blown to pieces.

Is there any way out? Maybe not. Mahmoud Abbas, the leading peace-seeker on the Palestinian side, is terribly vulnerable. He understands very well that he must end Palestinian violence against Israelis if America is to stay engaged in the effort to end Israel's occupation of Palestinian land. He is repeatedly undermined by Palestinians who do not share his logic. What he may not have expected was that he would be done down even more thoroughly by Ariel Sharon, his fellow peace-seeker, whose hand he had just been shaking at Aqaba.

The assassination attempt crushed Mr Abbas's effort to persuade the Islamist movement to agree to a ceasefire. Dr Rantisi propagates extreme views but is a politician, not a fighter. The Israelis hold him guilty, correctly, of actively opposing current peace plans: last week, in Hamas's name, he attacked Mr Abbas for betraying the Palestinian cause at Aqaba, and suspended the ceasefire talks. They also claim, perhaps less correctly, that he was behind the attack on the soldiers.

In any event, Mr Abbas's only hope of bringing bloodshed to an end, a precondition for moving ahead on the road map, is to reach an accommodation with Hamas. A ceasefire had seemed extremely difficult but not entirely impossible, so long as Mr Abbas could deliver something worthwhile from Israel in return. The assassination bid made him out to be a patsy, someone regarded with contempt by his Israeli counterpart.

Even now, hopeless as it seems, some sort of agreement with Hamas offers the only remote prospect of a peaceful way forward. Without popular support, or political legitimacy, Mr Abbas simply does not have

the power to send his security forces, weakened by Israeli attacks, to arrest Islamist or other militants. He might well not be obeyed.

Mr Bush's response to the assassination bid showed that he understands Mr Abbas's vulnerability, and the need to help him to do his job. In a rare rebuke to Israel, the president said that it would “make it more difficult for the Palestinian leadership to fight off terrorist attacks.” It would not, he added, help Israeli security. As if in answer to that warning came the bus bomb. The atrocity may have proved Mr Bush right, but it will have done nothing to soften his heart to the Palestinian cause.

Mr Sharon faces pressures of his own. Although the 15 settlement outposts that he has ordered dismantled are mostly uninhabited, the settler movement has responded angrily, threatening to create two new outposts for each one taken down. Mr Sharon must be seen to be tough on terrorism. And it is close to impossible for any Israeli government, let alone his, to trust in a “ceasefire” from a murderous organisation like Hamas. The fact is, there is no other way. Despite everything, Mr Abbas's troubled efforts to fashion such a ceasefire should be helped, not scorned.

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Iran's nuclear ambitions

Time to call a halt

Jun 12th 2003
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For all North Korea's bomb-making boasts, Iran's nuclear dabblings are just as troubling

NUCLEAR problems tend to proliferate. Brazen North Korea this week claimed that it needs the bomb to buy security on the cheap: to cut the size of its army, and put more cash into its decrepit economy. In fact, its nuclear weapons come dear: it has long been peddling missiles and drugs to feed its expensive habit, and is now trying to extort still more cash from its anxious neighbours. Coy Iran, by contrast, insists that its dabblings—the subject of a troubling report next week to the board of the International Atomic Energy Agency (IAEA), the UN's nuclear watchdog—are for peaceful purposes only. Yet Iran's nuclear ambitions pose at least as big a threat.

Taking Iran at its peaceful word stretches credulity. Its claim that expensive nuclear power will help save its vast reserves of oil and gas for export simply does not add up: the gas that its oil industry routinely flares off would generate several times the electricity expected from a controversial nuclear-power reactor that Russian companies are building at Bushehr. America has long accused Iran of using this civilian programme to mask covert efforts at bomb-making. Indeed, why else would Iran build a sophisticated uranium-enrichment plant, when Russia had agreed to handle all the fuel for Bushehr? And why seek to produce heavy water (extremely useful in making plutonium for bombs) when the existing power programme depends on light-water reactors?

Next week's report cannot answer such questions. It will, however, show that Iran ducked its obligation to report several of its only recently admitted nuclear activities. It will also regret that Iran refuses to accept more intrusive safeguards, drawn up in the 1990s after inspectors found how close Iraq had come to having a bomb without their knowing. But the bigger questions about Iran's nuclear intent are incendiary.

Iran says it may eventually agree to tighter safeguards—if America and others agree to sell it advanced nuclear technology, as Russia does. Given the suspicions, that is a non-starter. But since it became clear, earlier this year, that Iran had a far more sophisticated nuclear programme than outsiders realised, the Russians and others, including the European Union which hopes to build up trade ties, have pressed the government harder over extra safeguards. In principle these are worth having, but they are also now largely beside the point.

Even with inspectors breathing harder down its neck, Iran already has basic technologies needed for weapons-making. From now on it could stay even within the tougher rules, honing its enrichment and other skills that are all legal for civilian purposes under the Nuclear Non-Proliferation Treaty (NPT), until it was ready to break out of the treaty (90 days' notice is all that is required to quit) and go rapidly nuclear.

The danger cannot be underestimated. Whatever the damage from North Korea's blatant violations, letting Iran subvert the NPT's peaceful intent from the inside would make the treaty worse than useless. And in such an unstable region, the chain reaction set off by even a potentially nuclear-armed Iran could turn Saudi Arabia, Egypt and others nuclear at speed.

Time for NPT members to ask whether uranium enrichment and other weapons-capable technologies ought to be allowed to anyone under the treaty, or put under some sort of international control. But past time for Russia to suspend its nuclear dealings with Iran, and for Europeans to call off their trade talks. Iran will not see the benefit of giving up its nuclear option, unless the price of keeping it is driven up sharply.

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Britain and the euro

Can they be serious?

Jun 12th 2003
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That shocking decision: Britain will wait and see

Reuters

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THIS week the government announced its decision not to decide just yet about taking Britain into the euro. For those who found the newspapers' exhaustive Indecision Day multi-page supplements a bit taxing, to say nothing of the Treasury's 2,000 pages of analysis of selected aspects of the issue (with more to follow), the main thing to understand is quite simple: the policy is right, politically and in economic terms as well.

The government has promised a referendum on the issue, and at the moment there is no prospect that Britain will vote to abolish sterling. That takes care of the politics. Turning to economics, Britain is structurally and cyclically out of step with the euro-zone: joining now would be bad for Britain and, please note, bad for the existing members, which are in enough trouble already. Oh, the euro-zone's fiscal and monetary policies are wrong; best wait for that to be sorted out too.

Perhaps it would have made more sense therefore to rule the idea out for years, or for ever? Not at all. Economics and politics could easily move in favour of British membership. Why close the door in any case? No, the government's tried-and-tested policy of wait and see is fine. And please stop saying that this is the same Tory policy they used to mock. Cheap shots like that are unhelpful, and Europe is a serious subject.

Is it, though? One begins to wonder. Many of the leading participants in the Britain-in-Europe debate do seem to be joking. Take the euro-enthusiasts who argue that Britain has already wasted precious years outside the system. They say it with a straight face, but they cannot be serious, can they? The course of euro interest rates thus far is known; their path with Britain in the system would have been similar, and can be compared with British rates. You don't need 2,000 pages of analysis to understand that the British economy would have been far more volatile with the euro than it was with the pound. Perhaps those sooner-the-better types are really Eurosceptic plants, trying to discredit the cause by making it out to be impervious to evidence and common sense. Sneaky.

The government, for certain, is a big kidder. Consider the effort devoted to convincing people that Tony Blair (keen European) and Gordon Brown (decidedly less keen) are in total agreement—equally avid pro-Europeans, equally eager to rise to the euro challenge when the conditions are right. Nobody believes it! What a muddle! They're a riot, those two.

Some see their euro disagreement as a quarrel over the terms of Gordon Brown's accession to 10 Downing Street. When this came up in their amusingly strained joint press conference this week—rictus smile meets dissertation tending to infinity—Mr Blair said he wanted to talk about “substance not soap opera”. Another good one. When it comes to the euro, the last thing the prime minister likes to talk about is substance.

Everyone's a comedian

In this he is not alone. Eurosceptics revel in their nightmares about European tyranny and the end of 1,000 years of history. Europhiles, averting their eyes from the mess the existing euro-zone members

are making of their new monetary regime, perform the classic routine: “Britain is winning the argument in Europe.” This has them helpless over at the constitutional convention. The old ones are the best, and Mr Blair has promised that he will take “winning the argument” on tour again for his campaign to change Britain's mind on the euro.

Have you noticed, by the way, that this joke has deeper layers? Relish the contradiction. Clearly, Europhiles will be reconciled to the place in Europe they want Britain to seek only when they expect Britain to lose the argument a lot and do not care—or when there is no distinctively “British” argument to advance. This is what being one country in an ever closer union of 25 nations (and counting) entails. What could be more Anglo-chauvinist than a prime minister who constantly frames his vision of euro membership and European integration in terms of Britain's “winning the argument”?

Come to think of it, it is more sad than funny.

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Congo's war

Africa's open wound

Jun 12th 2003
From The Economist print edition

France's intervention in Congo is welcome, but not enough

EPA

“GENOCIDE” is an attention-grabbing word. Since the UN started speculating that it might apply to recent events in Congo, the world has suddenly noticed that country's five-year-old civil war. About time, too. Far more people have already died as a result of Congo's war than perished in Rwanda in 1994: guesses range from 2m to 4.7m. Some of the killing is motivated by ethnic hatred, but mostly it is about loot. Militias plunder and kill because there is no one to stop them. Someone should.

France's dispatch of troops to reinforce the UN's beleaguered peacekeepers in Bunia (see article) is a welcome first step. The locals were certainly pleased to see them, when they started arriving a week ago. The blue helmets already in Bunia had done nothing to prevent appalling massacres in and around the town last month, partly because they lacked numbers and equipment, partly because their mandate called on them to do little besides guard UN property. The French-led force is supposed to be different: 1,400 well-armed soldiers with clear orders to stop the militias from murdering civilians.

It ought not to be difficult for the French to make Bunia safe again. Their opponents are a rabble: skilled at slaughtering unarmed civilians, but no match for a modern army. The trouble is that beyond Bunia lies a country almost as big as western Europe, much of it racked by unreported microwars. France has no plans to pacify the rest of Congo. On the contrary, it has made it brutally clear that even its intervention in Bunia will be brief. By September 1st, its troops are to leave. By then, a long-delayed, larger UN force should have arrived.

Peace requires more than this. First, the warring parties must want it. Congo's government may, but the bandit-militias in the east do not. Suppressing them would require thousands of well-armed troops, and probably several years. It would help if the militias were not armed by rival governments. The culprits—Rwanda, Uganda and Congo itself—all depend on aid, and so might be bullied into stopping.

Some argue that the West should avoid embroilment altogether. There are no western interests at stake, and Africa's supply of strife seems endless: witness this week's mayhem in Liberia and the attempted coup in Mauritania. There is a limit to how many wars stretched western armies can stop. But in humanitarian terms, Congo is the big one, with more victims than any since 1945. Stopping it should be an urgent priority.

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Directors' insurance

Double indemnity

Jun 12th 2003
From The Economist print edition

Company executives should pay for their own mistakes

IMAGINE you are a former chief executive of a blue-chip company that is found guilty of “a particularly egregious fraud” by the world's top securities-market regulator. You, personally, are fined $1m, a record for such cases, and ordered to pay $7.6m as “disgorgement” of the gains you made out of the fraud. Stiff, you might think—were it not for the fact that your former employer picks up the tab for the $7.6m, leaving you with the fine and a net gain of $6.6m.

Pure fiction? Far from it. This is the “punishment” meted out by the Securities and Exchange Commission last week to Paul Allaire, boss of Xerox in the late 1990s, when the copier company injected non-existent profits into its accounts to the tune of $1.4 billion. Xerox's bylaws indemnify its executives for all such charges, so the company will be paying Mr Allaire's $7.6m, as well as the $11.8m that the SEC has demanded from five other Xerox executives. The only real punishment is the five-year ban on Mr Allaire serving as a director or officer of a public company, plus the more distant threat from a criminal investigation by the Department of Justice.

To the moral hazard created by Xerox's bylaws (which are quite common in corporate America) must be added the moral hazard from the fact that the company hopes to get the money back from its insurers. Its directors' and officers' (D&O) insurance policy covers executives against the legal consequences of their business mistakes. The insurers, who have received premiums of $4.9m from Xerox this year, are likely to resist the claim. They do not pay up for fraud, and although the Xerox executives have (as the convenient wording always goes in such cases) neither admitted nor denied wrongdoing, the insurers will argue with some justification that this is mere semantics. Yet either way, the executives are going largely unpunished for a fraud that occurred on their watch.

The way out of this mire is for companies to stop buying D&O insurance for their directors. The sagacious Warren Buffett of Berkshire Hathaway does not buy it for his board. Some may argue that, without such protection, it will be impossible to find decent directors. That is hard to believe. Directors could still buy their own insurance, as most doctors have to do for malpractice. With directors and officers buying insurance directly, there would be no need for company bylaws to indemnify their mistakes and let them keep the proceeds even of egregious fraud. Instead, directors would be in the desirable position of paying for their own mistakes. What could be more accountable than that?

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Letters

Jun 12th 2003
From The Economist print edition

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Armless?

SIR – It was precisely the lack of evidence and, more particularly, the inability of the Bush and Blair teams to prove the existence of "a clear and imminent" threat which formed the basis of so much opposition to the war in Iraq ("Secret weapons", May 31st). Many people across the globe will doubtless rest easier that such an unsympathetic character as Saddam Hussein no longer controls Iraq. But the point was, and is, whether it was justifiable for heavy-handed international politicians to sanction the invasion of a sovereign state. On the evidence before us, then and now, the answer seems to be "no".

Mark Chewter
Bangkok

SIR – A few years after calling for Bill Clinton's resignation for lying about his sexual escapades ("Just go", September 19th 1998), you seem remarkably sanguine about the possible exaggeration or fabrication of Iraq's military capabilities. Wilfully misrepresenting evidence in order to lead a country to war goes well beyond scandalous; indeed, it is criminal. While history may "judge the second Gulf war on a number of criteria", one wishes *The Economist* would judge the leaders of democracies rather more strictly.

John Parker
Washington, DC

SIR – The prospect of a huge risk does not require a very high probability before it triggers the duty to act to prevent harm. In defence of your courageous prime minister and our common-sense president, to concede even a reasonable probability that someone of Saddam's malevolence had any programmes for producing weapons of mass destruction justified an aggressive and timely intervention—particularly given Iraq's permeable borders and shady associations. Anything less would have constituted foreign-policy malpractice.

Jay Gaskill
Alameda, California

Take me out of the ball game

SIR – Lexington identifies baseball's antitrust exemption as the source of its problems (May 31st). Other sports leagues lack an exemption but are less competitive from a business standpoint. American football and basketball leagues, and those of several less-popular sports, cap each team's player payroll. National Football League teams share all television revenues equally. The league, rather than individual teams, sells the TV rights to all games. NFL teams have also forced cities and states to build stadiums for them by threatening to leave town.

Unlike other big American sports, the baseball-players' union wields substantial power, resulting in the highest average salaries. However, the union has been at war with the owners for 30 years. The main causes of baseball's fall in popularity are a tendency to go on strike every four or five years, the owners' mismanagement through, among other things, overexposure (almost all of the 2,430 games each year are televised) and dilution of talent by increasing the number of teams.

Donald Spratt
Bel Air, Maryland

Up for the cup

SIR – Charlemagne exaggerates the early reluctance of “British” football teams to enter the first European Cup (May 31st). Hibernian, a Scottish side, accepted an invitation to play in the inaugural tournament, reaching the semi-final stage.

Stephen McLellan
Dunfermline, Fife

Free to disagree

SIR – You say that demonstrations in Hong Kong, such as the candle-lit vigil held on June 4th, may be banned in the future under proposed legislation implementing article 23 of the Basic Law (World this week, June 7th). This is simply not true. Our national-security (legislative provisions) bill has proposed that all its provisions must be interpreted, applied and enforced in accordance with chapter three of the Basic Law, which protects freedom of speech, association, procession and assembly, among others. The proposed legislation will not undermine in any way fundamental rights and freedoms currently enjoyed by the people of Hong Kong.

Timothy Tong
Permanent secretary for security (acting)
Hong Kong

Moderate Muslims

SIR – One positive effect of the most recent terrorist bombings in Riyadh and Casablanca is a timid re-emergence of the moderate Muslim voice (“Synchronised crime”, May 24th). The crackdowns against militants in Saudi Arabia and Morocco, as illiberal as they may be, seem to have the support of the average Muslim on the street. Is this the beginning of a resurgence of moderate Muslim rationalism born of self-preservation? Could this be the beginning of a beautiful friendship between reform-minded Muslims and the governments of the Middle East?

Nicholas Shenkin
Oakland, California

Fundamental but vague

SIR – It is not surprising that the EU constitution's charter of fundamental rights engenders worries about the fate of national autonomy (“Tidying up or tyranny?”, May 31st). Nor is it shocking that some parties urge for “an explanatory commentary, limiting the charter's impact on national legislatures, attached to the constitution.” The best formula for such a commentary might call for ambiguity, rather than specificity. Witness America's Tenth Amendment: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”

Such vagueness satisfied both anti-federalists (who understood “delegated” to mean “expressly delegated”), as well as federalists (who viewed the amendment as tautologous, hence harmless). The text's precise purport only emerged with subsequent case law governing civil rights and Roosevelt's New Deal. Some may say that hard cases make bad law. Churchill agreed that case law is indeed the worst method of constitutional clarification—except for the others.

Timothy Chambers
Providence, Rhode Island

Military withdrawal

SIR – It is time to acknowledge that there is no military solution that the West can offer the developing world (“The undead”, May 24th). Bureaucrats have a hard enough time picking the “right” side in ongoing conflicts even to consider applying military might to one side or the other. If there is a real spirit of charity towards developing nations, perhaps a good first step would be to ban weapon sales. I imagine

that the rifle and rocket launcher shown in the picture accompanying your article were not developed and constructed in Congo.

Joel Hiltner
Farmington, Maine

Reasserting the law

SIR – Frank Scheelen (Letters, May 31st) is incorrect about Moore's law. A doubling every 18 months does indeed imply exponential growth. You can check this easily on a calculator, if yours has enough transistors.

Joe LaCasce
Oslo

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Dealing with Iran

Next on the list?

Jun 12th 2003 | TEHRAN
From The Economist print edition

AFP

As America goes on wondering what to do about Iran, more evidence emerges of the theocracy's nuclear dissimulation

ASK Condoleezza Rice, George Bush's national security adviser, and she wants an Iranian regime that gives priority to women's rights and modernity. A Republican senator proposes allocating public money for the promotion of secular democracy in Iran. Neoconservatives assert that students in Tehran long for liberation. For a country that has spent almost a quarter of a century isolated from Iranians, America is remarkably sure of what is good for them. And, after Iraq, Iran is now feeling the fresh glare of its attention.

Bill Clinton's government tended to sympathise with the clearly expressed desire of most Iranians to be led by Muhammad Khatami, the twice-elected and reform-minded president, and his supporters in parliament. Now, as Mr Khatami fades, the Republican administration does little to distinguish him from conservatives such as Ayatollah Ali Khamenei, the supreme leader who supervises the country from a pedestal of unaccountability. The business of both men, the Americans say, is defending a detested theocracy.

Some evidence supports this view. At February's council elections, once-enthusiastic voters stayed away; in Tehran, a miserable 12% of the electorate cast a ballot. Visiting Iranian expatriates are shocked by the volubility with which their compatriots disparage the whole regime, not just the conservative bit of it. Those who can—the brainy young electrical engineers, for instance, who stroll into the finest American universities—emigrate at the first opportunity.

The reformist parliament that was elected in 2000 has been a failure. Deputies recently ratified two presidential bills designed to hobble unelected conservative institutions, only for the bills to be rejected by the most egregious of those institutions, a de facto upper house called the Council of Guardians. Women's rights, press freedom, trial by jury; in all these areas, Mr Khatami's supporters have enacted enlightened legislation, only for it to be vetoed—in the case of trial by jury, more than a dozen times.

Last month, a majority of reformist deputies addressed a remarkable letter to the supreme leader. They accused institutions under his purview of creating the impression that Iran cannot change. Mostly because of the deputies' elliptical call for Mr Khamenei to step aside, newspapers were forbidden to print the letter, and the signatories are under pressure to withdraw their names. Thugs disrupt their speeches. The office of one was bombed.

The conciliatory Mr Khatami vows to renegotiate the passage of the two blocked bills, one of which would make it hard for conservatives to stop reformists standing in the next parliamentary elections, in 2004. Few expect him to succeed. If the Council of Guardians then prevents parliament from calling a referendum on the bills, at least 25 deputies promise to resign. In that case, says Tehran's chief prosecutor, they could go to jail.

Progress towards the conclusion of Iran's protracted crisis has slowed to a crawl. For the EU, which is negotiating a trade and co-operation agreement with Iran, that crawl, and the chance to influence it, warrant engagement. Iran is more open about the state of its prisons than it was in the past. A moratorium on the stoning of adulteresses seems to have held. The EU trade deal may be years distant, but movement is just sufficient to keep the Europeans interested.

Unengaged Americans are less patient. The American media exaggerated the size and character of last autumn's modest student protests. (Mr Bush joined in, hailing them as evidence of social change.) In fact, Iran's reformist failure has generated far less ferment than apathy and introspection. The small minority of Iranians who dream of American intervention are the most apathetic of the lot.

Since he was elected, Mr Bush has resisted detente in favour of co-operation on specific issues. Iranian special forces helped the Northern Alliance during the war in Afghanistan and gave America useful intelligence. Iran's role in Afghanistan's political reconstitution was mostly constructive. Last year, Iran encouraged an Iraqi group it influences, the Supreme Council for Islamic Revolution in Iraq (SCIRI), to team up with other groups that were being organised by America into an opposition to Saddam Hussein. During the war, the Iranians turned a blind eye to American violations of their airspace and coastal waters.

Meddling and masking

But America identifies a deeper pattern of transgression. At the beginning of 2002, Iran was caught shipping arms to the Palestinians. Al-Qaeda agents in Iran may have had a hand in last month's lethal bombings in Riyadh. In Iraq, the Americans have detained SCIRI operatives on suspicion of attacking American forces. Most damaging of all, on June 6th, Iran's improbable claim that it does not seek nuclear weapons was further undermined by leaks from a UN report asserting that it had withheld sensitive information (see article).

Few of these misdeeds had much to do with Mr Khatami; a few, in fact, may not be misdeeds at all. The president apparently knew nothing about the cache of arms before Israel intercepted it. (Hardliners, who control a panoply of military and intelligence organisations, were almost certainly responsible.) Even now, there is disagreement about what kind of support to give Islamic rejectionist groups.

AFP

A very slow stroll to reform

According to one well-travelled parliamentarian, the fall of Saddam Hussein has restricted Iran's ability to ship arms, destined for rejectionists, across Iraq to Syria. Hizbullah, which Iran helped Lebanon to start in the 1980s, continues to defer to Mr Khamenei, but the supreme leader has, on occasion, permitted Mr Khatami's foreign minister to moderate its behaviour. According to a knowledgeable western official, there is no evidence of Iranian collusion with suspected al-Qaeda members. Iran, for its part, blames Pakistan for shunting undesirables across the common border.

About six weeks ago, says the same western official, a decision was taken to send Iranian agents into Iraq, to influence events if things fell apart. Again, this reflects less badly on the reformists than their rivals. Senior conservatives exert far greater influence over the SCIRI than Mr Khatami. Iran's ability to fish in troubled Iraqi waters, furthermore, is severely circumscribed by memories of ancient and modern wars between the two countries.

When it comes to Iran's nuclear programme, however, outside worries are more warranted. Nuclear development is one of the few issues on which Iranians on both sides of the political divide agree. They have unwisely come to regard their ambiguous nuclear status as a protective cloak, especially since Mr Bush included Iran in his axis of evil. Many senior Iranians are convinced that Mr Bush has decided to try

to topple the Islamic Republic; they suspect that the pressure he is applying on the nuclear issue is designed to soften them up.

The longer Iran digs in its heels, the less inclined Europe will be to defend it. “It's going to be interesting,” says an EU diplomat, “to see if they're willing to sacrifice [the trade deal].” But Iranian fatalism with regard to Mr Bush's intentions may be premature. The Bush administration, for want of a consensus within it, gives every impression of having deferred a decision on what sort of policy to have towards Iran. On June 4th, Douglas Feith, a senior Pentagon hawk, said that America would support Iranian “aspirations to live in freedom”—without, typically, explaining exactly what that meant.

Since last year, the United States has been beaming pop music and anti-regime chat into Iran. Mr Bush is being urged to apply secondary sanctions to non-American companies that invest in Iranian energy. Royal Dutch Shell, for one, has been warned that its plans to help develop a massive Iranian oilfield could affect its ability to win contracts in the United States. The adminstration clearly wants the Iranian regime to change. But for some in Washington's right-wing think-tanks, and for elements on the Pentagon, this is not enough. They believe that the Iranian regime *must* be changed. Indeed, they say, evidence against Iran on the nuclear question and terrorism is stronger than the evidence that was used against Mr Hussein.

If this argument is to be acted on, it makes sense to identify Iranian opposition figures capable of putting the case for regime change and willing to help achieve it. But Mr Feith acknowledged the difficulty of this when he tried to stifle suggestions that the Pentagon wants to use the People's Mujahideen, an armed Iranian opposition group based in Iraq, as an Afghan-style Northern Alliance.

A front for the Mujahideen, the National Council of Resistance of Iran, has been a useful conduit for embarrassingly accurate revelations, thought to have been collected by western intelligence agencies, about Iran's nuclear programme. The Mujahideen's military forces are trained and used to be well armed, though their heavy weapons are now in the possession of American forces in Iraq. They loathe the Islamic Republic.

For the moment, however, they make unsuitable partners. The State Department considers them terrorists. Their leader, Massoud Rajavi, has strange ideas about the cult of personality (his own). In Iran, their association with Mr Hussein, who provoked the terrible Iran-Iraq war of the 1980s, will not easily be forgiven.

It is possible, Iranian officials concede, that the Mujahideen could reinvent themselves as a political organisation. The State Department is being urged to declassify them, which would give the Pentagon more chance to fraternise. Mr Feith's claim that America is treating them as a terrorist group is nonsense. The Mujahideen have been allowed to keep their light arms, and Mr Rajavi will not see Guantanamo Bay.

No new shah, thank you

Most Iranians have little time for a second candidate to lead the opposition, Reza Pahlavi. The son of the former shah is American in manners—he lives in Virginia—and a professed democrat. Back home, however, he has an image problem. His father ran a state that was decidedly less democratic than Mr Khamenei's. The people who ousted Pahlavi *père*, even if they regret what arose in his place, are unlikely to welcome Pahlavi *fils*.

The main reason for the dearth of attractive leaders outside Iran is their abundance inside it. Many, even if they acknowledge the failure of Mr Khatami's movement, describe themselves as reformists and lean towards a version of democracy that Ms Rice would endorse. To the frustration of expatriates living in America, few of them are inclined to use violent methods, or to lay down their lives, to end the stalemate. (In this, they typify the vast majority of Iranians.) They fully expect, one day, to assume power.

The nuclear ticking intrudes awkwardly. If it gets too loud, Iran's political evolution may be interrupted by violent, externally provoked change. That would be a disaster, because Iran has even less need than Iraq for American placemen. On June 9th, more than 2,000 people gathered outside one of Tehran's big universities, shouted radical slogans, and went home. More gatherings will happen this summer, though neoconservatives should not exaggerate them. They are part of the crawl.

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Iran's nuclear programme

Fissionable

Jun 12th 2003
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What the UN's inspectors have found around the place

IS IRAN secretly building a bomb? And if so, is there much anyone can do about it? Suspicions that it was up to no nuclear good intensified earlier this year when officials from the International Atomic Energy Agency (IAEA) reported that Iran was building a surprisingly sophisticated uranium-enrichment plant at Natanz. First reports of this plant, and another for making heavy water at Arak, had come last year, not from the Iranian government but from an exiled opposition group. Both enriched uranium and plutonium have legitimate civilian uses, but they are also essential as the fissile cores for bombs.

Next week, the IAEA will report its “concern” about other discrepancies its inspectors have found since Iran belatedly owned up to its enrichment activities in February. According to the confidential report, Iran failed to inform the agency, as it should have done under its existing nuclear-safeguards agreement, of the importation in 1991 (from China, though the agency does not say it) of 1.8 tonnes of natural uranium, and what it then did with it. Iran says it can account for the lot, but inspectors are still checking.

On this, and much else, they have more questions than answers. Why, for example, did Iran turn some of the imported uranium into uranium metal? This is a bomb ingredient that can also be used in some kinds of reactor fuel, but not the sort Iran's planned reactors would use.

Iran also claims, as the IAEA report will say, that it is building a sophisticated enrichment facility at Natanz—a pilot plant, due to start operations this month, where more than 100 centrifuge casings have already been installed, and a much larger commercial plant that will eventually have 50,000 such machines—without experimenting elsewhere first. The Iranians say they have done lots of modelling and simulation. But inspectors have been keen to take samples at a workshop of the Kalaye Electric Company in Tehran, where Iran admits only that some centrifuge components were made. The opposition whistle-blowers suggest a closer look at two laboratories near Karaj, west of Tehran. Others suspect Iran had outside help too, possibly from Pakistan or North Korea.

And why does it need to enrich uranium at all, since Russia has agreed to handle all the fuel for the 1,000MW electricity-generating reactor its companies are building at Bushehr? Because, says Iran, over the next 20 years it intends to build several more reactors, with a total capacity of 6,000MW. Meanwhile, it aims to master all the technologies of the nuclear-fuel cycle, and to that end it is starting to build a fuel-manufacturing plant at Isfahan.

Now that the IAEA has oversight of Natanz, it can at least check that only low-enriched reactor-grade uranium is produced there, not the highly-enriched stuff needed for bombs. But until Iran accepts the IAEA's more stringent safeguards, brought in after Iraq had come close to a bomb without its knowledge, the agency cannot check for illicit enriching elsewhere.

Similar worries attend Iran's recently announced plans to build a 40MW heavy-water research reactor. All part of its civilian power effort, says Iran—and belated justification for the heavy-water plant at Arak. But spent fuel from the planned CANDU-type reactor is ideal for extracting bomb-grade plutonium. Indeed, North Korea claims to have made a clutch of bombs already from the plutonium-rich spent fuel of its 5MW reactor, though this has a different design. Being able to reprocess plutonium and enrich uranium would give Iran a choice of weapons technologies.

Next week's IAEA report will press Iran to agree to toughened safeguards. Russia says it is doing the same; so is the European Union; so did the G8 summiteers this month. But the G8 declaration, says Gary Samore of the London-based International Institute for Strategic Studies (IISS), was if anything a victory for Iran. More stringent checks, he argues, although they might help pick up other clandestine nuclear activity, could not now stop Iran from eventually developing all the skills it needs to break out of the Nuclear Non-Proliferation Treaty (NPT) at a time of its choosing, and go nuclear.

Is there anything that could? As a long shot, Mr Samore has suggested a concerted diplomatic push, offering incentives to wean Iran from its enrichment and reprocessing efforts. Others see the need—and, after the defeat of Iraq, Iran's hostile neighbour, the opportunity—to start a new security dialogue in the region that encompasses all weapons of mass destruction, including Israel's bomb.

George Bush has refused to rule out any option in dealing with proliferation. Would he risk a military strike? That seems excluded for the present, but a hardline chorus inside and outside the administration is bound to grow, especially if Iran pulls out of the NPT. So far the administration has called the reports of Iran's nuclear activities “troubling”. Its chief anti-proliferation diplomat, John Bolton, said in congressional testimony last week that if the IAEA finds Iran not in compliance with its safeguards obligations, the case for opposing all enrichment and reprocessing capabilities in Iran, and for ending all nuclear co-operation with the country, would be “compelling”. In other words, it is not only Iran, but those who help it, that will feel what Mr Bolton called “the logic of adverse consequences” for proliferators.

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The economy

Poised for growth?

Jun 12th 2003 | WASHINGTON, DC
From The Economist print edition

Katz Aurora

Perhaps, but don't expect anything like a boom

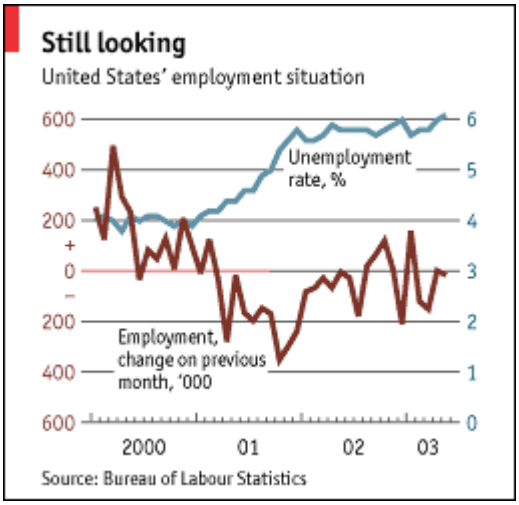
Get article background

IS AMERICA'S economy finally set to shake off its funk? An increasing number of economists on Wall Street and politicians in Washington seem to think so. Many number-crunchers are forecasting a sharp acceleration of economic growth in the summer. John Snow, America's treasury secretary, suggested this week that the economy could be growing by around 4% by the end of 2003, more than double its current rate. After so many false dawns, is this optimism justified?

Financial markets certainly think so. All the big stockmarket indices have risen dramatically. The Dow Jones Industrial Average is now over 9,000, up more than 20% since mid-March; the technology-laden NASDAQ is up almost 30% from three months ago. Financial conditions have loosened across the board. Not only are government bond yields at historic lows, but spreads on corporate bonds have narrowed sharply, making access to capital cheaper and easier for firms of all kinds. A weaker dollar—the greenback has dropped by 8% against the currencies of America's trading partners this year—has also added to the loose financial conditions.

And there is more to come. Judging by recent comments from its top official, America's central bank is highly likely to cut interest rates when its policy-setting Federal Open Market Committee meets on June 24th-25th. Alan Greenspan and other central bankers have become increasingly concerned about the risk of deflation, and are determined to ward it off. With America's economy still swimming in spare capacity, the rate of inflation continues to decline. Core consumer prices—that is, excluding volatile categories such as food and fuel—were flat in both March and April, after several months of small increases. As economists at Goldman Sachs point out, that brings the annualised rate of core consumer-price inflation over the past six months to below 1%, the lowest rate in almost four decades.

Although Mr Greenspan reckons that the likelihood of “corrosive” deflation in America is low, he intends to “lean over backwards” to avoid it. That means cutting short-term rates, and keeping them low. Judging by the prices of futures contracts, investors now expect a quarter-point rate cut with certainty on June 24th, and see a 50% chance that short-term rates will be cut by half a percentage point.



Nor is looser monetary policy the only stimulus on the way. Mr Bush's latest tax package, signed into law on May 28th, will undoubtedly give the economy a short-term boost. The huge tax package—worth $350 billion over ten years if you believe Congress's gimmicks, and costing more than $800 billion over a decade if you take a more realistic view—may not be particularly efficient as a stimulus package. But it is big. Economists at Morgan Stanley reckon the tax cut will add about $160 billion, or 1.5% of GDP, in fiscal stimulus over the next four quarters, bigger than any tax change since the Reagan tax cut in 1981. Of that, around $64 billion will reach Americans quickly in the form of rebate cheques and less tax withheld from their pay. Even if a large chunk of this is negated by tax hikes and spending cuts at the state level, the net effect will still be a sizeable stimulus—and an increase in the budget deficit. The Congressional Budget Office this week raised its deficit forecast for fiscal 2003, which ends in September, to over $400 billion, or around 4% of GDP.

Add together loose financial conditions and a fiscal boost, and it is hard to imagine that the economy will not improve at all. Lower financing costs are continuing to prop up the housing market and maintain the surge in mortgage refinancings. The weekly tally of mortgage refinancing applications reached a new high of nearly 10,000 last week.

Even in the gloomy labour market, there are glimmers of hope. True, America's jobless rate hit a cyclical peak of 6.1% in May, and weekly unemployment claims are still extremely high. But the employment report released on June 6th was in many ways less bad than expected. Although the economy lost 17,000 jobs in May, the number of private-sector jobs was flat; the drop came in government posts. The number of temporary jobs rose by a healthy 58,000, and a rise in temporary workers is often a sign that firms are thinking of hiring permanent workers again. The latest monthly survey of purchasing managers also suggests that conditions in both the manufacturing and services sector are already improving, although they are far from booming.

A trickier question is whether any rebound will last. Can America's economy expect above-trend growth next year, for instance? There, it is much harder to be optimistic. America's economy still has huge fragilities. Although firms have undergone great adjustments since the excesses of the stockmarket bubble, there is still plenty of spare capacity around, making a sustained investment boom less likely.

More troubling is how long America's consumers can continue to fuel the economy. Levels of consumer debt are rising sharply, driven largely by the refinancing boom. According to Jan Hatzius, an economist at Goldman Sachs, household debt is growing at a 10.3% annual rate, more than twice the trend growth rate of disposable income. The ratio of household debt to disposable income is at an all-time high but, with interest rates falling, the ratio of consumers' debt-service bills to their income is below its historical peak.

Clearly, the rate of consumer debt accumulation cannot be sustained. At some point, it will have to slow, which means lower consumer spending. Falling interest rates and tax cuts will put off the day of reckoning, but not for ever. That, more than anything, is why the recovery may be less robust than the optimists expect.

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The labour market

Make mine a latte

Jun 12th 2003 | BOSTON AND NEW YORK
From The Economist print edition

A new role for America's coffee houses

EIGHT in the morning, and seats are filling up fast at the coffee house on the corner of 3rd Street and Avenue A in New York. All day long, the café swarms with young professionals clicking away at laptop computers and gabbing on mobile phones. Business is being done. But there's a hitch: many of these frenetic patrons are out of work.

The story is the same at the Torrefazione Italia, on a chic stretch of Boston's Newbury Street. Alana Raftery, who used to be in software sales, sits there for hours with an iced coffee and paperwork. On Fridays, she pushes tables together with five other women to plan a software-services venture.

America is becoming a café culture. But the reason is less Starbucks marketing than the economic downturn. The white-collar army of the unemployed are making cafés their offices and job-search centres. Going there every day provides the same sort of structure and routine as a formal office—but with much better coffee.

Of course, cafés have long served as the locus of business activity for independent consultants, creative types and teleworkers (as well as brewing-places for novels, coups and revolutions). But the new clientèle is different. In contrast to previous recessions, more professionals are out of work. Technology has changed, too, allowing people to job-hunt or devise new business plans untethered from their clunky desk computers and tangled-cord home phones. Moreover, with the number of cafés growing from under 2,000 in 1991 to over 14,000 today, these people now have plenty of places to go.

Their habit may also herald a deeper trend in the workforce: an era of nomadic teleworkers, whose jobs are no longer tied to one particular spot. Quinn Mills, a professor of economics at the Harvard Business School, believes that companies, “with their urge to regiment”, are unprepared for this. Not only the unemployed, but workers too, may prefer to decamp to Starbucks: great for reducing overheads, but perhaps less good for productivity.

For coffee houses themselves, their new status as job centres has helped the industry buck the slumping economy. In 2002, the gourmet-coffee sector earned a record $8.40 billion in revenue, with cafés accounting for more than half the sales. Many coffee houses, belonging both to publicly-traded companies and independent retailers, are reporting sales growth of roughly 7%. And though $4 for a cappuccino may seem steep, it's pretty good for a New York *per diem* office rent.

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Medicare reform

Pre-emptive surrender

Jun 12th 2003 | WASHINGTON, DC
From The Economist print edition

Yet again, principle loses out to action

CONGRESS has been trying for several years to expand Medicare (the federal programme that provides medical insurance for almost all elderly Americans) to include prescription drugs. Now it may be on the verge of succeeding, with the House and Senate converging on similar plans. So put out the flags? Not at all. In reality, the near-agreement marks yet another defeat for prudent government.

Nothing could be more irresponsible than expanding one of America's biggest entitlement programmes without trying to introduce structural reform (such as competition to hold down prices, or means-testing to make sure the government does not end up paying for pills for millionaires). Yet this is what a Republican-dominated Washington is about to do. The new drugs benefit could cost between $350 billion and $400 billion over the next decade—and produce no structural reforms worthy of the name.

The impending legislation marks a defeat for the White House. In his state-of-the-union address in January, George Bush unveiled a scheme to link drugs benefit with structural reform: old folk who agreed to join private health plans would get more money for medicines. But the Senate balked at the idea of a "two-tier" system. And on June 9th the White House agreed to accept equal drugs benefits for people in the ordinary Medicare programme.

Why have the Republicans failed to support structural reform? One reason is the strength of the rural contingent in the Republican caucus—and particularly the influence of Charles Grassley, a senator from Iowa and the chairman of the Finance Committee. Rural politicians (who have long complained that they fail to get their fair share of the nation's medical budget) have no enthusiasm for private health plans, since such plans do not exist in the empty reaches of the countryside.

The other reason is the pressure to get something done. Republicans have been making ever-louder promises to provide drug benefits for the elderly for several years. The old are one of America's most powerful lobbies, capable of tilting elections in any battleground state, not least Florida.

For its part, the White House is anxious to burnish the president's reputation as a man who gets things done at home, as well as in deserts and Middle Eastern seaside resorts. This willingness to abandon principles in the blind desire to produce results is becoming a theme of the Bush presidency. This week, for example, the White House urged House Republicans to forget virtue and approve a Senate bill that extends the child tax credit to 6.5m low-income families, most of whom pay no income taxes in the first place.

Congress's willingness to add a new entitlement to Medicare without tackling its structural problems is a disaster in the making. Not only is the number of people claiming Medicare set to double by 2030, but the cost of providing health care for each beneficiary is likely to double too. Joseph Antos, a health-care specialist at the American Enterprise Institute, has a horrifying verdict on the "reforms" working their way through Congress: "We are descending to the lowest depths of hell."

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Lawsuits

Erin Brockovich fights again

Jun 12th 2003 | LOS ANGELES
From The Economist print edition

And a movie sequel rears its head

BEVERLY HILLS is not all Botox, *faux*-Spanish mansions and imported sports cars. It also has cancer clusters, and these have become Erin Brockovich's latest crusade. Ms Brockovich, a beauty queen turned filing clerk, sprang to fame in 1996 when she stumbled on evidence that Pacific Gas & Electric had been polluting the local water supply. The result was the largest toxic tort case in American history and damages of $333m for the residents of Hinkley, a tiny place in the Mojave Desert to the north-east of Los Angeles.

Ms Brockovich, still as famous for her cleavage as her detective work, has since evolved into an all-American heroine. Julia Roberts has played her on the big screen. She hosts her own television show, “Final Justice”, lectures on self-empowerment and has recently written an autobiography entitled “Take It From Me, Life's A Struggle But You Can Win.”

Her latest claim, made with her boss, Ed Masry, is that toxic fumes from oil wells beneath Beverly Hills High School have caused more than 216 cases of Hodgkin's disease, non-Hodgkin's lymphoma and thyroid cancer since the 1970s. Such statistics are 20 times higher than the national average for these cancers. At a press conference on June 9th in their Westlake Village offices, the pair announced that they had filed 21 individual lawsuits at the Los Angeles Superior Court against the local school district, the South Coast Air Quality Management District (AQMD), and the oil companies that have drilled at the site since the early 1980s. Venoco, a privately owned firm, holds the current lease, but its predecessors were Chevron, Texaco and Gulf Oil, all with much deeper pockets.

Also present at the press conference was Lori Moss, a 1992 Beverly High graduate, who first sparked Ms Brockovich's interest in the case. Ms Moss was diagnosed with Hodgkins Disease in 1996. Extensive therapy pushed the disease into remission, but in November 2001 she found another lump on her neck, which was thyroid cancer. Many other former Beverly High pupils are suffering from similar ailments. When Ms Brockovich held a meeting at the Beverly Hills Hotel to recruit potential litigants, more than 600 people came.

Although everyone knows that Beverly Hills has oil—a large derrick sits on the corner of the school campus—residents were never fully aware of the size of the operation. Beneath the school are 18 active oil wells and natural-gas pumps, as well as a large processing plant which transfers the gas immediately into local pipelines. Local authorities get royalties of $700,000 a year from the 450 barrels of oil and 120,000 cubic metres of gas which the plant produces every day. Yet Ms Moss says that when she would come home from school complaining of headaches, “my family would joke that it was a brain tumour.”

Both sides are now marshalling their defences. Gwen Gross, the school superintendent, claims that the levels of airborne toxins are well below health limits established by the state. She cites Barry Wallerstein, a Beverly High graduate and executive officer of the AQMD, who maintains that “pollution levels of toxic air contaminants [are] within normal ranges.” Medical experts have also refuted the claims, pointing out that the three types of cancer in question have never been linked to petroleum products in the past. But Ms Brockovich is undeterred. “I have 300 cancers staring me in the face and an oil-production facility underneath the school,” she says. “It doesn't take a rocket scientist to figure out that the two fit together.”

The story has a twist. In 2000, Venoco won an award for letting terminally ill children build a multi-coloured shell round the campus rig at Beverly High. The giant monument, known as the “Tower of Hope”, was painted with flowers and has become a local landmark. Did it cover up a sinister secret? In a town where fiction and reality go hand in hand, “Erin Brockovich in Beverly Hills” may be at your cinema

sooner than you think.

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Head to head in the Senate

A fuss over filibusters

Jun 12th 2003
From The Economist print edition

Frustrated Republicans want to curb a Senate institution

TEMPERS are rising in the Senate, the best-mannered corner of American politics. The Republican majority is proposing the senatorial equivalent of a pre-emptive strike: a change to the Senate's rules. Democrats are so outraged that they are, as politely as possible, threatening to bring the august chamber to a dead halt.

In the course of a recent floor debate, Bill Frist, the Republican leader in the Senate, proposed “with regret but determination” to restrict the right of senators to “filibuster” a presidential nomination—in other words, to keep talking until the nomination is withdrawn or shelved. The Senate Rules Committee has also held a hearing on the subject. The 51-strong Republican caucus has been enraged by the success of Democratic filibusters this year in blocking George Bush's nomination of two conservatives to federal judgeships.

The dispute may seem arcane, but filibusters have been a prominent and colourful feature of Senate procedure almost from its inception: a way for a passionately committed minority to stop the majority from passing a measure. The longest speech ever given by a filibustering senator was Strom Thurmond's, of 24 hours and 18 minutes, against the Civil Rights Act of 1957. To prepare himself for this marathon, Mr Thurmond visited a sauna to dehydrate himself so that his bladder would not cramp his eloquence.

“The filibuster may be famous, but it is hardly sacrosanct,” declared Mr Frist. His proposal would gradually reduce the number of votes needed to end the filibuster of a nomination—known as a “cloture” vote—from the current 60 to 51 or less in a procedure that could take a mere two weeks. The change is needed, he says, because Democrats have “tainted” the nomination process by refusing to allow a vote.

The Democrats have responded by calling his proposals a threat to “constitutional liberties”, pointing out that the Senate has confirmed 127 of 129 Bush nominees to the bench. Mr Frist's change, claimed Tom Daschle, the Democrats' leader, would reduce the Senate to “a rubber stamp”. Mr Frist needs 67 votes to win the rule change, so his chances of success are slim. Some Republicans are muttering about yet another obscure procedure, dubbed the “nuclear option”, to get around that obstacle. But if Mr Frist endorses that, say Democrats, they will use every available tactic to stop all Senate business.

Both sides have ransacked history to justify their arguments. Mr Frist is right that Senate rules are not sacrosanct. The number of votes needed to cut off a filibuster was reduced from 67 to 60 as recently as 1975. And it is true, too, that most filibusters have been used to stymie legislation rather than to block nominations.

But the Republicans seem out on a limb with their claim that filibusters are somehow “unconstitutional” because they frustrate the will of the majority. The entire constitution is an anti-majoritarian document—the Electoral College and the Supreme Court, two such features, together delivered the presidency to Mr Bush when he lost the popular vote. The Senate itself, in which each state has two members regardless of its population, is another example. Senate rules are riddled with blocking devices.

The Republicans are also being a bit disingenuous when it comes to judicial nominations. Filibusters have not usually been used against lower-court nominations, but they have been employed against Supreme Court nominees. In 1968 a Republican filibuster successfully derailed the elevation of Abe Fortas, a sitting justice, to the chief justice's post. William Rehnquist, the current chief justice, made it to the court in 1971 only after the Republicans had defeated a Democratic filibuster.

There's the rub. Justice Rehnquist is widely expected to resign from the court at the end of this month.

Sandra Day O'Connor, another Republican appointee, may do so as well. Tempers are fraying not because of the use or abuse of Senate rules, but because everyone in the Senate is preparing for what is expected to be a battle royal over the confirmation of Mr Bush's nominations to replace them.

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Illinois politics

Business as usual?

Jun 12th 2003 | CHICAGO
From The Economist print edition

A new broom doesn't sweep quite so clean as people hoped

WHEN Rod Blagojevich took office as governor of Illinois early this year, people were moved by his pledges to purge the sleaze from Springfield. True, these pledges were probably unrealistic; but as the state's first Democratic governor since 1977, young, eager, and slightly unpolished (he kept quoting his idol, Elvis Presley, on election night), Mr Blagojevich seemed worth the benefit of the doubt.

It was disappointing, therefore, when a deal that smacked of the old smoke-filled rooms was rushed through the Illinois General Assembly last month and immediately signed by the governor, all in less than four days. The law allows SBC Communications, the local telephone provider, to raise the fees it charges rivals to use its phone lines, probably putting up everyone's phone bills in the process.

Opponents of the change ranged from consumer advocates to the lieutenant-governor. But SBC's point-man on the issue was its president, William Daley, the brother of Chicago's mayor, Richard Daley, and a former United States secretary of commerce—in short, as close as Illinois gets to royalty. With clout like that, plus an army of high-paid lobbyists, backing from key labour unions and the support of the leaders of the two state chambers, the complex bill whizzed through before many legislators had even read it.

On June 9th, though, even royalty was pulled up short. The rate law was labelled “anti-competitive” and bad for consumers by a US District Court judge, Charles Kocoras. Judge Kocoras blasted Mr Blagojevich and the Illinois General Assembly for exceeding their authority and side-stepping the state regulatory process. Has Rod “the Reformer” fallen off the track?

A broader review of his first months in office suggests this may be too harsh. Far from cosying up to state legislators, the governor has gone to some lengths to appear as an outsider. He frequently derides “business as usual” in state government, and has alienated himself from many legislators in the process. On June 12th, Mr Blagojevich was expected to announce that he would use his veto to reinvigorate an ethics bill that was watered down as it went through the legislature this spring.

The governor's outsider strategy was evident during the recent budget debate, when he spent so much time in Chicago, rather than Springfield, that legislators accused him of deliberately avoiding them. In the end, he succeeded in balancing the budget (as state law requires) and stuck to his campaign pledge not to raise taxes.

Impressive stuff. Yet critics contend that the governor has used risky assumptions about recovery, and one-time measures—such as selling state buildings and leasing them back—to close the gap, deferring the pain to next year. Ralph Martire, of the bipartisan Centre for Tax and Budget Accountability, reckons that Illinois will face a $2.5 billion-$3.5 billion structural deficit alone over the next ten years, which will be impossible to erase without tax increases or huge spending cuts.

So far, his relationship with Chicago's Mr Daley has had more influence on the young governor than any ties he has forged in Springfield. The mayor, who sailed to a fifth term earlier this year, has long been a leading figure in Democratic circles. If Mr Blagojevich harbours serious ambitions for national office (there are wild murmurs of him as a vice-presidential candidate next year), Mr Daley's support will be vital. This goes a long way to explaining not just SBC's rate change, but the governor's keen support of Mr Daley's support to expand O'Hare, Chicago's main airport. Why rain on the king's parade when you may need him some day?

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Lexington

St George and the dragon's hoard

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The failure to find banned weapons in Iraq raises deeper questions about pre-emptive war

DRAGONS not only breathe fire but guard precious treasure in caves. The allies' failure, so far, to find banned weapons in the Iraqi cave has unleashed a wave of rhetorical fury. “Embarrassing.” “Fraudulent.” “Completely unscrupulous.” Even, “Arguably the worst scandal in American political history.” Along with the rhetoric grows a suspicion that the Bush administration may have deceived Congress and the public with claims that were, at best, misguided and, at worst, deliberately misleading.

So far, the rumpus in America has been modest compared with Britain, where Tony Blair's leadership has been under ferocious assault. George Bush's reputation as a man of integrity easily outweighs doubts about his administration's judgment. Unless evidence of deliberate deceit is forthcoming (and so far, there is no sign of it), that is likely to stay true. Established perceptions are difficult to shift.

Still, a squall is gathering. The secretary of state, Colin Powell, and the head of the Central Intelligence Agency, George Tenet, have both had to defend themselves in public. Leaks from CIA officers have appeared, complaining about interference in their work. Three congressional committees—two in the Senate, one in the House—have said they will conduct inquiries.

There is no doubt that the highest in the land should look embarrassed, to say the least. “The Iraqi regime continues to possess and conceal some of the most lethal weapons ever devised,” said Mr Bush this March. “Simply stated, there is no doubt that Saddam Hussein now has weapons of mass destruction.” That was Dick Cheney last August. “We'll find them. It'll be a matter of time to do so.” Mr Bush again, in May.

But the question should not be: do people look silly after the event? They do, though they could yet be vindicated (remember that took it four years to unearth Iraq's bio-weapons programme in the mid-1990s, and then only because of inside information). Rather, the questions should be: was the intelligence good enough to provide the administration with an accurate assessment of Iraq's weapons? And did politicians manipulate intelligence—deliberately or not—in order to get the answer they wanted, or first thought of?

Plainly, the intelligence was not good enough. By all accounts, the quality of American intelligence in Iraq declined after the mid-1990s, when the United Nations inspectors left. According to the *New York Times*, some intelligence reports about Iraq's weapons programmes were based on projections of what Saddam

Hussein would have been doing in the late 1990s had he still acted as he was doing in the early 1990s.

Adding to the confusion were bureaucratic battles among the intelligence services. The Pentagon relied increasingly on its own intelligence operations and clashed with the CIA. Disputes over information were understandable, perhaps inevitable. But, through rivalry and excessive reliance on Iraqi defectors, the Pentagon may have ended up making matters worse.

Does it therefore follow that the Bush administration acted improperly in using partial intelligence to construct its case for war? Some have accused it of doing so. For example, Hans Blix, the chief UN weapons inspector, says “bastards” in the administration conducted a smear campaign against him and “leaned on” his team. Yet the fact is that intelligence rarely provides clear-cut answers. It is usually partial and almost always requires interpretation. Moreover, everyone's intelligence services said Iraq had weapons of mass destruction, not just America's. If America was wrong, so was everyone else.

In conditions of such uncertainty, the administration therefore looked at Saddam Hussein's pattern of behaviour. He certainly had had weapons of mass destruction in the mid-1990s, and had used them before that against his own people. He threw the UN weapons inspectors out. Those inspectors said large quantities of biological agents remained unaccounted for as recently as this year. Mr Hussein refused to explain what he had done with this evil stuff, in contrast to South Africa and Ukraine when they disarmed.

At the time, therefore, the administration surely had reasonable cause for thinking Mr Husssein still had weapons of mass destruction. It is also worth pointing out that if Iraq really did get rid of its weapons sometime after the mid-1990s, then some aspect of American policy—sanctions, or the threat of force, or force itself—must have worked. And, of course, whether he was hoarding banned weapons or not, Mr Hussein was still a dragon. The failure to find weapons of mass destruction does not negate the moral and humanitarian reasons for overthrowing him.

Did you say “imminent”?

But these were not the stated reasons for war. One of those reasons was Iraq's failure to comply with UN resolutions; another was that America was under imminent threat. To many overseas observers, Mr Bush thus appeared to be invoking a doctrine of pre-emptive war. When the UN refused to authorise an attack, the president justified action on the grounds that America could wait no longer in the face of a threatening enemy with such appalling weapons at its disposal.

The doctrine of pre-emption is obviously hugely controversial. Even its supporters argue that such a war would be justified only with compelling evidence of an imminent attack. A judgment based on a preponderance of evidence should not be enough.

But will the evidence ever be good enough? This raises the most important public-policy issue for America to debate, and one that it has so far balked at. Once Congress weighs in on the quality of intelligence and the use made of it, it needs to ask: what are the circumstances in which America should invoke the doctrine of pre-emption?

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Politics in Mexico

Fox puts a presidential face on some worrying electoral computations

Jun 12th 2003 | MONTERREY
From The Economist print edition

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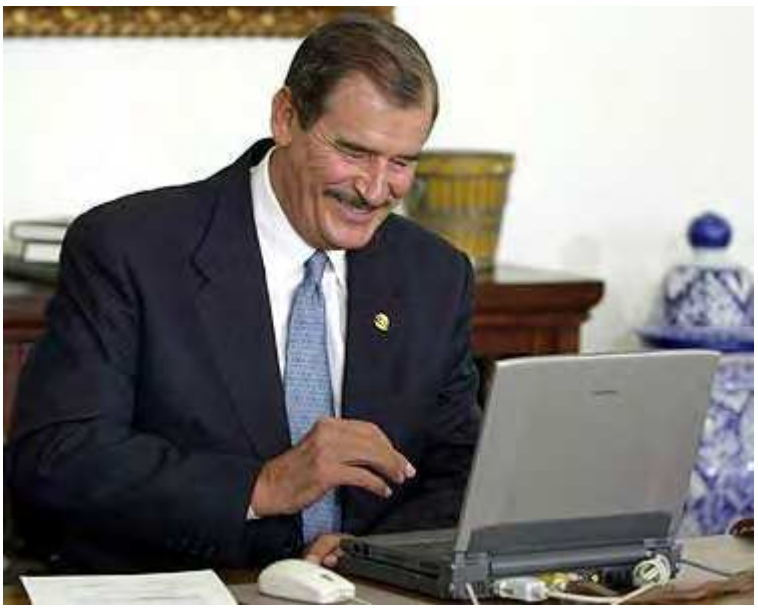

A crucial mid-term vote promises little joy for the minority government, and a comeback for the opposition PRI

Get article background

MONTERREY, the capital of the border state of Nuevo León, is Mexico's most industrial and Americanised city. It is also a bastion of the voter insurgency against the once-omnipotent Institutional Revolutionary Party (PRI) which culminated in Vicente Fox's capture of Mexico's presidency three years ago. In the northern border states, Mr Fox's conservative National Action Party first began to erode the PRI's monopoly of power in the late-1980s. Its victory in a 1997 election for the governorship of Nuevo León was a crucial breakthrough that paved the way for Mr Fox's national triumph. But now the political mood in Nuevo León is changing again—and that could be bad news for Mr Fox.

On July 6th, Mexico will hold a mid-term election, for the 500 seats in the lower house of congress, as well as for many state and local posts. These contests will decide the fate of Mr Fox's presidency, which lasts until 2006: until now, his ambitious plans for reform have been stalled by his lack of a majority in Congress.

Yet his chances of winning control of Congress next month look slender, if Nuevo León is anything to go by. Not only does the PRI candidate for governor lead the opinion polls by 14 points, but his party looks set to take back the mayor's office in Monterrey after three successive PAN administrations. A recent national poll for *Reforma*, a Mexico City newspaper, tells a similar story: it shows that support for the PAN has slipped from 47% to 37% in under a year, while that for the PRI has risen from 34% to 37%. The leftist Party of the Democratic Revolution has 17%.

Other polls put the PAN at 39%. But party strategists reckon they need to win at least 45% to clinch a majority of the seats in Congress. If his party fails at least to displace the PRI as the largest party, then Mr Fox risks becoming a lame duck half-way through his term, and Mexico will have squandered an opportunity for change.

Three years ago, the PRI was dismissed by many pundits as a party of “dinosaurs” that would quickly disintegrate without the glue of executive power. So why is it now doing so well in a state like Nuevo León? The explanation lies in the PAN's inability to deliver promised changes, which has disappointed former PRI voters who switched to it in 1997 or 2000, says Aurelio Collado Torres, a political scientist at Monterrey's Technological Institute. Fernando Canales, the state's governor from 1997 until he became Mr Fox's economy minister this year, promised more jobs, better transport and less crime. None of this has happened, claim opponents.

This mirrors the PAN's problems in the congressional election. Mr Fox admits that he raised expectations too high in 2000. The PAN is now paying the price. The sense of enthusiasm and expectation Mr Fox's triumph generated has all but evaporated. The president is still popular (with an approval rating of around 64%). So was his refusal to support the Iraqi war of his erstwhile friend and ally, George Bush. He has had some successes this year, including the negotiation of a grand-sounding accord with Mexico's farmers, which has reduced tension in the countryside.

The PAN had originally hoped to win Congress on the president's coat-tails. But Mauricio Fernández Garza, the party's beleaguered candidate for governor in Nuevo León, says the president has no plans to campaign on his behalf. Mr Fox campaigned vigorously in local elections in the state of Mexico earlier in the year. But this did not prevent an increase in the PRI vote. It looks as if the fabled “Fox effect” no longer works for the PAN. Instead, aides now talk of a “Rose Garden strategy”, in which Mr Fox will stay in Los Pinos, the Mexican White House, looking presidential, in the hope that the lustre of the office will provide electoral gain.

The PRI, too, is happy to eschew anything as controversial as a national debate on the issues that will determine Mexico's future, such as foreign investment in the energy sector. Indeed, the PRI is cleverly avoiding taking on Mr Fox at all. As one PRI candidate puts it: “There is no national campaign, only 300 local ones.” (That is the number of electoral districts; 200 more congressmen are chosen nationally by proportional representation.) The party's candidates have almost total discretion as to how they campaign. Most restrict themselves to the minutiae of local issues.

The PRI still has a reputation for corruption and skulduggery. So in Nuevo León, for example, the PRI's candidate for governor, José Natividad González, has rebranded himself as representing the Citizens' Alliance, a group that contains three other small parties. Mr González is proud that in Nuevo León his party now has more women and young people as candidates than the PAN. These were constituencies that backed the PAN in 1997 and 2000. “The PRI is changing, the PAN not,” he claims. He sees his campaign as offering lessons for the presidential race of 2006. The PRI also hopes to do well in tight races in local elections in the states of Sonora and Jalisco.

Another factor handicapping the PAN in northern Mexico is the economy. The region has born the brunt of job losses during three years of stagnation. Conversely, in central and southern Mexico, where the economy has been more resilient, the PAN hopes to make inroads in areas where it has traditionally been weak.

All is not yet lost for the PAN and Mr Fox. In Nuevo León, the fight for the federal congressional seats looks as if it will be tighter than those for governor and the mayor of Monterrey. And even in those races, the polls are still recording too many undecided voters for the PRI to relax. But at present, it looks as if next month's vote will usher in three more years of pain and frustration for Mr Fox's government.

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The Dominican Republic

Swindled

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A bank fraud leaves unanswered political questions

THE slogan at Banco Intercontinental, the Dominican Republic's second-largest commercial bank, was, “Everything is possible.” It was, including gold Rolex watches and private jets for its most favoured clients. The bank's recent collapse has left Dominicans with a large bill, tainted the country's political leadership and undermined one of the Caribbean's more successful economies.

Even by Latin American standards, the collapse of Baninter, as it was known, amounts to an unusually large swindle. In April, when it was taken over by the government, the bank was reported to have totted up losses of $2.2 billion (a sum equal to 13% of the country's GDP). Last month, the bank's main owner, Ramón Báez Figueroa, was arrested. Officials accuse him of operating a secret “bank within the bank” for more than a decade. He and his associates are said to have siphoned off a chunk of the bank's deposits for their own use. Banking regulators and the bank's auditor, PricewaterhouseCoopers, were apparently deceived by the bank's software program, which kept the diverted deposits off the books.

Mr Báez was known as one of the country's richest and most influential businessmen, with four private planes and a similar number of yachts and helicopters. His largesse was legendary. According to an investigation by the central bank, the country's president, Hipólito Mejía, and his predecessor, Leonel Fernández, each received bulletproof vehicles from Baninter. The bank also picked up the bill for their foreign trips. Mr Mejía's head of security got ten gold Rolex watches said to be worth $15,000 each, as well as the free use of a credit card. The bank also gave mobile phones to officials, and stipends to 70 generals.

Mr Báez has denied the accusations. He claims that the government is persecuting him in order to take over his media empire to help a campaign by Mr Mejía to change the constitution so that he could seek a second consecutive term as president.

The central bank's governor, José Lois Malkun, has said the government will repay out-of-pocket depositors. To do so, he has been shopping for a loan of $1 billion. But the affair has already strained confidence: the peso has depreciated, and the country's credit rating has been downgraded.

Moreover, foreign governments and international financial institutions may be reluctant to help while Mr Mejía remains in power. An election is due next year. If Mr Mejía is allowed to run, his chief opponent is likely to be Mr Fernández, who also has some explaining to do. For much of the past decade, the Dominican Republic could claim to be something of a success story, thanks to tourism, remittances and export industries. The Baninter scandal is likely to cast a dark cloud over a sunny country for a while yet.

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Venezuela's economy

On the breadline

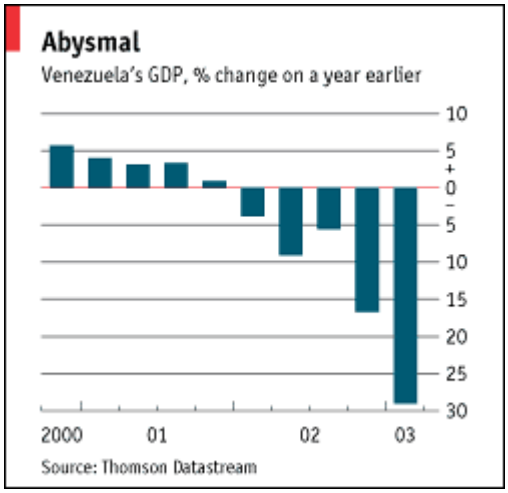
Jun 12th 2003 | CARACAS
From The Economist print edition

The cost of political incompetence

Get article background

BY ANY standard, it is a staggering figure: Venezuela's economy contracted by 29% in the first quarter, compared with the same period last year. That spells hardship for millions of Venezuelans. According to Datanálisis, a market-research firm, 72% of households say they have cut back on food; only half now eat three meals a day. Unemployment stands at 20%. Of those officially counted as employed, more than half work in the informal economy.

Much of the GDP shrinkage is the result of a two-month general strike, a failed bid by the opposition to oust President Hugo Chávez. This shut down the vital oil industry in December and January, just when prices were high. Oil output is now almost back to normal. But the economy is not: many forecasters expect a decline of 12% or more for the year.



In early February, Mr Chávez, a populist former army officer, imposed foreign-exchange controls. Since then, the government has approved the sale of just over $100m; in normal times, business would demand that sum every three days. On the black market, dollars now cost 50% more than the official rate. The dollar shortage has also prompted a bizarre stockmarket boom: shares in CANTV, the telephone company, which is also quoted in New York, rose by 68% in May, as investors realised they could swap them for a dollar-denominated American depository receipt, and thus for dollars.

Officials admit that the agency set up to administer the controls was incompetent; it was recently placed in the charge of the Finance Ministry. But opponents see the dollar shortage as a deliberate ploy to strangle what is left of Venezuela's private sector. So far, the dollar drought has not provoked serious shortages of staple goods, though it may yet do so. But what it has done is to continue Venezuela's deindustrialisation—one of Mr Chávez's main gifts to his country. Six out of ten of the manufacturing businesses in existence when the president was first elected in 1998 have since shut down, according to the industrialists' association.

Mr Chávez has blamed the economic catastrophe on the opposition strike. So far, that has worked: one Venezuelan in three still supports the president. But as the strike recedes, three out of four respondents now tell pollsters that the government is primarily to blame for the economy's collapse. The polls also suggest that Mr Chávez would lose a referendum on his presidency, which under the constitution can take place any time after August.

There are also signs that the president may lose his slim majority in the National Assembly. Pro-government legislators held an extraordinary session in a public park last week. They voted to change the parliament's rules, so that the opposition could no longer hold up pending laws which would augment the executive's already wide powers. But in a full session of the assembly this week, they could not muster the votes to ratify the rule changes.

Eventually, his economic mismanagement may catch up with Mr Chávez, eroding the loyalty of all but his most fanatical supporters. That ought to spell the end of his regime. But not necessarily. The opposition

has won few friends among the growing number of uncommitted Venezuelans, who show little enthusiasm for politicians of any stripe.

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Brazilian electricity

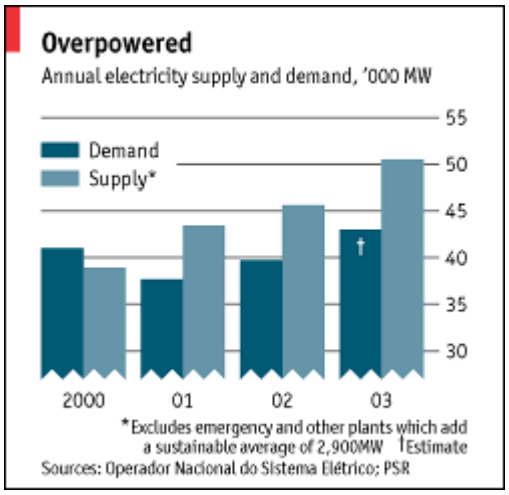
Lighting a candle

Jun 12th 2003 | SÃO PAULO
From The Economist print edition

Fixing a messy, half-privatised electricity industry

BRAZIL'S market for electricity is almost as volatile as its exchange rate, and with consequences that are nearly as disruptive. In 2001, when drought cut output from hydroelectric dams, the government told Brazilians to chop their electricity use by a fifth. They complied. But that has created the opposite problem: a glut that has helped to push many electricity companies deep into debt. Investors have backed away. When demand eventually picks up, shortages could reappear. Electricity has become a fizzing political issue, and the first regulatory challenge for President Luiz Inácio Lula da Silva.

To Lula's left-wing Workers' Party (PT), this dysfunctional industry looked like an ideal candidate for state intervention. Its problems stem partly from the mismanaged privatisation of electricity distribution, and a fumbled attempt to get generators to compete. In the 1990s, foreign investors were eager for a slice of Brazil's energy market. They paid high prices for distribution companies before the rules and a regulator for the privatised industry were in place. Often, they took out dollar loans to finance their purchases. Then, just when power rationing shrank the business, Brazil's currency crashed.



The result: even though tariff rises for household consumers have outstripped inflation, the distributors want bigger increases. AES, a tarnished American giant which owns the biggest distributor, has defaulted on loans from a Brazilian bank; other distributors are trying to restructure debt. Meanwhile, many generators cannot find customers. Some customers, such as a utility owned by the state of Paraná, are backing out of contracts. Last year Brazil's electricity companies, excluding those belonging to Eletrobrás, the main state-owned generation and transmission firm, lost 11 billion *reais* ($3.8 billion).

The Workers' Party came to office denouncing the “market model” and promising to resurrect “strategic planning”. But as with its macroeconomic policy, stern realities seem likely to trump ideology in the government's new model for electricity, soon to be unveiled. The state cannot afford the $6 billion a year of new investment needed for supply to keep pace with demand once the economy recovers. Electricity policy may also set a pattern for future PT initiatives, by smuggling a social programme into an economic one. This carries a cost. Ironically, it may be paid partly by the people it is intended to help.

If Brazil is to see new investment in electricity, the government must tackle two problems. The first is fuzzy and erratic regulation. Distributors claim, for example, that in setting tariffs the regulator has valued their assets at market prices rather than at what they paid for them, ignoring the effect of devaluation. That will cost them 16 billion *reais* in revenue, they say. Investors have also been unnerved by government threats to curb the regulator's independence. “How can you feel comfortable if you fear every four years the laws and regulations can be changed again?” asks Claudio Sales, an industry lobbyist.

The second problem is structural. Demand is volatile and difficult to forecast. And generators must grapple with Brazil's unusual reliance on hydroelectricity for 90% of its supply. Once built, dams churn out electricity more cheaply than new gas-fired plants can manage.

Whom to comfort, the state or private investors, and how, has been at the heart of a five-month debate

over the government's “new energy model”. The goals, says the energy minister, Dilma Rousseff, are to hold tariffs down, to give “just remuneration” to investors and to connect up the 13m Brazilians who lack electricity. The method, still being refined, is likely to be an investor-friendly sort of state-guided planning.

Under the current system, generators are at the mercy of the market. If demand is too low, they risk not finding buyers. During shortages, generators are often forced to supplement their output by buying in the spot market, at stratospheric prices. Mrs Rousseff wants to eliminate such risks. The new model may oblige distributors, with government help, to forecast demand, and to contract adequate new generating capacity. Generators would be paid a flat fee for building new plants. If the planners commission too much capacity, consumers would pay.

This scheme has virtues. Assured of steady returns, generators might build new plants. State-owned hydroelectric generators would be paid according to their (low) costs rather than the market rate. This would hold tariffs down, and reduce the risk of state companies crowding out private ones by subsidising new plants with profits from old. Electricity connections for the poor should become affordable. Mrs Rousseff also says that the regulator's role will be “reinforced”.

Overall, the model should please both consumers and investors. But there are drawbacks. One is that it may transfer to consumers too much of the risk of excess supply. Another is that, by capping the price paid to hydro generators, it would in effect subsidise electricity at the expense of other social needs, such as education.

Even with steadier policies, electricity firms, traumatised by problems in Brazil and in their home markets, may hesitate. “I'm pretty sure capital will not flow back quickly to Brazil,” says Charles Wortman of the São Paulo office of J.P. Morgan Chase, an American bank. Still, the Workers' Party may yet conquer the scepticism of investors in energy as it has done, more quickly, in the financial markets. If efficiency suffers, few will notice.

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Japan and South Korea

Closing ranks

Jun 12th 2003 | SEOUL AND TOKYO
From The Economist print edition

AP

It has not been a good week for North Korea's Kim Jong Il

HE MAY not get invited to many summits, but Kim Jong Il usually finds a way to ruin the party. On June 9th North Korea's official news agency upstaged the final day of a meeting in Tokyo between South Korea's recently elected president, Roh Moo-hyun, and Japan's prime minister, Junichiro Koizumi. A statement said that North Korea had a right to seek “nuclear deterrence” against “hostile” American policies. It was one of the North's clearest public declarations yet—though worse things have been said privately—that it is intent on developing a nuclear capability.

For all the bluster, however, Mr Kim had reason to worry about the summit in Tokyo. Messrs Roh and Koizumi had many bilateral issues to discuss, from efforts to put their countries' awkward history behind them to plans for boosting trade and investment. Top of the agenda, though, was their joint effort, in concert with America, to get North Korea to back away from its previous nuclear threats.

The two leaders issued a statement on June 7th which repeated what Mr Roh had said previously: that any move by North Korea to develop nuclear weapons would not be tolerated. And although Mr Roh said that he would prefer not to talk much about the potential consequences of bad behaviour—he hopes to help Mr Kim save face—he did concede that “we should carry out dialogue and pressure side by side”.

This is precisely the united message that America and Japan have been trying to send North Korea. George Bush won support for this approach in his own meetings with Mr Roh and Mr Koizumi last month. America's two main allies in Asia have now affirmed it in a meeting of their own. Moreover, Mr Roh's handling of several other events in the past week suggests that the North's Mr Kim is having a hard time splitting South Korea away from the powerful countries arrayed against him.

Start with Japan. The Japanese public's fear of North Korean ballistic missiles and weapons programmes, and outrage over last September's revelations about its abducting of Japanese nationals, have made it much easier for Mr Koizumi to take a strong line on security issues—issues that his predecessors would have fudged. On the day that Mr Roh arrived in Tokyo, for example, Japan's parliament passed new “contingency” laws making it easier for the country's armed forces, hitherto severely constrained by Japan's pacifist constitution, to respond quickly to attacks at home.

This was a step towards normality for Japan, and the sort of thing that prickly neighbours might pounce on, even though the moves are purely defensive in scope. Yet Mr Roh took the laws' passage in his

stride, enduring the inevitable abuse from politicians at home. Lee Sang-bae, chief policymaker of the opposition Grand National Party, dismissed Mr Roh's entire trip as “idiotic diplomacy”, saying that he could not understand why the president “toasted the Japanese emperor on Memorial Day and made a visit to Japan on the day when contingency bills were passed.”

Nor did Mr Roh balk when a North Korean ferry, the *Man Gyong Bong*, had to cancel a port call in Japan over the weekend after Japanese authorities threatened to search her. The ferry has been named by Japan's government as a frequent courier of dual-use technology and illicit money to North Korea. Clamping down on such shipments—Japan is looking closely at other ferries too—certainly seems more like pressure than dialogue. And just to drive home the point, Mr Roh confirmed, while in Japan, that he would not meet his North Korean counterpart bilaterally until the current nuclear impasse is resolved. Mr Kim could not have taken much cheer from the Roh-Koizumi summit.

He could not have been pleased, either, by America's announcement, just before it, that it would be pressing ahead with plans to restructure its forces in South Korea. Paul Wolfowitz, the deputy Pentagon chief, confirmed that the 2nd Infantry Division, which accounts for 14,000 of America's 37,000 troops in South Korea, would eventually be moved back from the front lines, to south of Seoul.

The Pentagon has been talking about such a move for months, as part of its overall plans to make its 100,000 troops in Asia more nimble and less vulnerable to attack. It has raised hackles in South Korea, though. Some Koreans accuse the United States of abandoning it, others of setting the stage for an attack on the North. Yet Mr Roh, who drew a large chunk of his electoral support from young anti-American voters, has reluctantly accepted the shift. His only request was for America to wait until after the current nuclear tensions subside before making the move.

So what happens next? Senior officials from America, Japan and South Korea will meet in Hawaii on June 12th and 13th, and are expected to call for multilateral talks. North Korea has tried to insist on bilateral talks with the Americans, while American officials insist that the nuclear problem must be solved by including all of North Korea's regional neighbours.

What America is not prepared to do, whatever the format, is to give commitments to North Korea that will make it easier for the regime to avoid collapse. This approach is what Mr Kim deems “hostile”, and he still hopes to bully South Korea into breaking ranks with its allies. This week, he looked like failing.

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Culture in the Koreas

The silver screen of peace

Jun 12th 2003 | SEOUL
From The Economist print edition

The arts are bringing the Koreas closer together

WHILE the world argues about whether to take the peaceful or the warlike approach in dealing with North Korea, some people have already made their choice. Even as the North remains distant from the South in the political and economic arenas, cultural co-operation is more active than ever.

The isolated North has recently become receptive, showing South Korean films, promoting its artists in the South's capital, Seoul, and even jointly producing cartoons. It has also decided to resume South Korean tourist cruises to its Mount Kumgang resort this month.

The latest news-making event was the simultaneous opening of a South Korean film, “Arirang”, in the North Korean capital, Pyongyang, and in Seoul on May 30th. A story about the suffering of Koreans under Japanese occupation, the remake of a 1926 classic by South Korea's Na Woon-gu was produced to celebrate Na's 100th anniversary this year. Sadly, the film bombed in the 45 South Korean cinemas where it was shown, though in the North's two it was said that people were “very moved”.

The arts are benefiting from other cross-border exchanges, such as those involving animated films. Having co-produced “Lazy Cat Dinga”, the first North-South work, last year, the two Koreas are now working on “Empress Chung”, based on a famous folk tale. In March, Seoul's Hanaro Gallery held an exhibition, sponsored by National Geographic Channel Korea, of prominent North Korean artists. The 31 it featured were all big names in the North, designated “peoples' artists” and Kim Il Sung prize laureates.

As for sport, the Koreas agreed in April to hold a joint event on the South's island of Jeju in July. The date, though, may have to be postponed, because of worries about the SARS virus and, it seems, because of renewed political tension between the two countries. Cultural diplomacy can achieve only so much.

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Myanmar

Dialogue of the deaf

Jun 12th 2003 | BANGKOK
From The Economist print edition

Despite Aung San Suu Kyi's arrest, Myanmar's neighbours won't get tough

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AFP

Razali wants to go on talking

AUNG SAN SUU KYI, Myanmar's most famous dissident, is “well and in good spirits”, according to Razali Ismail, a UN envoy. If the latter, she has little reason to be. Myanmar's military junta arrested her last month, and had not let anyone see her until Mr Razali secured a brief meeting on June 10th. He was able to confirm that she had not been injured, contrary to reports issued by some opposition groups. But he made no headway on his other two goals, to secure her release and to revive talks about putting an end to military rule. Meanwhile, the events surrounding her arrest, and the fate of other members of her National League for Democracy (NLD), remain as much a mystery as ever.

The junta still claims that NLD supporters started the fight that led to Miss Suu Kyi's arrest, by trying to force their way through a crowd of pro-government demonstrators on a road near the northern city of Mandalay. But American diplomats, sent to the scene to investigate, found sharpened bamboo stakes and wooden clubs, along with bloodstained clothing. They concluded that “government-affiliated thugs” had launched “a premeditated attack on Aung San Suu Kyi's motorcade.” Exile groups also dispute the claim that only four people died in the mêlée, putting the figure at up to 100.

The generals have not yet produced Tin Oo, the elderly deputy leader of the NLD, or any of 16 other missing activists who were with Miss Suu Kyi. But they have promised an inquiry, and say they will release Miss Suu Kyi soon. Mr Razali thinks she might be free within a couple of weeks. But the regime is hardly a model of expeditiousness—it has been promising to restore democracy for 15 years. Even if the generals do release her, they have made it abundantly clear that they are not interested in dialogue. Than Shwe, the most senior figure in the junta, could not even find time to meet Mr Razali at any point during his five-day visit. Mr Razali nonetheless says he will be back in Myanmar soon.

Some countries are pushing for a more confrontational approach. America has announced it will not issue visas to members of the Union Solidarity and Development Associations, the government militia suspected of mounting the attack on Miss Suu Kyi. It has also promised to push for legislation tightening sanctions against Myanmar. And it has asked Myanmar's neighbours to take a tougher stance.

Regional pressure might be more effective, but it will also be the harder to mobilise, though Colin Powell says he will be trying next week. On a visit this week to the White House, Thaksin Shinawatra, Thailand's prime minister, signed a joint statement demanding Miss Suu Kyi's release. But at the same time, officials in Thailand were still insisting that dialogue was the best means to influence the junta. China, another influential neighbour, is hardly one to criticise repressive regimes. If Miss Suu Kyi knew how timidly Myanmar's neighbours were reacting to her arrest, she might be less cheerful.

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Afghanistan

A question of resolve

Jun 12th 2003 | KABUL
From The Economist print edition

Enter the suicide bomber

Get article background

AROUND eight in the morning on June 7th, at the dusty edge of Kabul, a taxi tried to slip into an armoured convoy accompanying a bus of German peacekeepers to a flight home. At some point, the taxi swerved and detonated its charge. The blast lifted the bus off the road, killing four Germans and injuring 29 others. The attack smacked of al-Qaeda, although there was no claim of responsibility. Suicide is said to be unAfghan. “I guarantee this man was a foreigner,” said the Afghan president, Hamid Karzai.

The response from Germany and other countries in the 5,000-strong force charged with keeping the peace in Kabul was unblinking. There would be no retreat into armoured vehicles, said the Germans' generals. Such steadiness will do wonders for German-American relations. But what of Afghanistan?

The attack signals a new phase in hostilities. Seventy-seven peacekeepers of the multinational force have been killed in accidents or by landmines (62 in a plane crash), but last weekend's deaths were the first from hostile action. “More attacks are likely,” said a security officer. “Where there is one suicide bomber there is usually a nest.” The worry is that the bombers may turn now to softer targets. A suicide attack on one of the United Nations compounds would probably see a mass evacuation of UN staff from Kabul.

But the bombing may equally be a sign of al-Qaeda's weakness. What little influence it had in Afghanistan after the American-led defeat of the Taliban has been lost. Its attempts to smuggle in men and weapons from Pakistan have often failed. Several of its would-be bombers have accidentally blown themselves up before killing others. The greater threat to Afghan stability comes from a resurgent Taliban, still apparently under the sway of its one-eyed former commander, Mullah Mohammed Omar. The “neo-Talibs”, as they are called, are thought to have loosely allied themselves with a former enemy, now fellow-traveller, Gulbuddin Hekmatyar. Their hope is to destabilise the Pushtun south and east of Afghanistan with incursions from their bases in Pakistan and—why not?—muscle in on the drug trade.

It is unclear how many foot soldiers Messrs Omar and Hekmatyar have, or how determined they are. Neo-Talibs will certainly have been sobered by the rout of their comrades in a battle near the southern Afghan town of Spin Boldak on June 4th. Forces loyal to the governor of Kandahar, Gul Agha Sherzai, were tipped off that a band of neo-Talibs had slipped across the border, perhaps hoping to embarrass the Afghan interior minister, who was visiting Spin Boldak that day.

Mr Sherzai's lot, on this occasion from two clans usually at each other's throats, chased the neo-Talibs from one mud hut to another, shooting all 40 of them, including several noted commanders. The Afghan authorities dumped the bodies of 21 of them in Pakistan—a reminder to the government there to help put an end to such incursions. Not our dead, came back the response from Pakistan snippily, along with most of the bodies.

The question now is one of resolve: of the international peacekeepers and the ramshackle Afghan government on one side and al-Qaeda and the neo-Talibs on the other. This bloody week may mark the beginning of the end for someone, but just who remains to be seen.

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Kazakhstan

Waiting to be rich

Jun 12th 2003 | ALMATY
From The Economist print edition

Mystery of the oil billions

JUST as in Soviet times, the people of Kazakhstan have long been promised a better life. Oil, they have been repeatedly told over the 12 years since independence, will make a difference. During the 1990s, oil reserves in the Caspian Sea basin were thought to be enormous, matching those of the Gulf states. Although those estimates turned out to be exaggerated, the true size of the reserves is still substantial. Over the past few years, Kazakhstan has doubled its oil production, to almost 1m barrels a day in 2002, and plans to reach more than 2m by 2010.

In anticipation of the oil bonanza, Kazakh officials have studied the experience of other countries that suddenly found themselves rich in natural resources. Alarmingly, the result in some cases has been lower growth rates, poor governance and an increase in corruption. In August 2000, President Nursultan Nazarbaev issued a decree for the creation of a national fund, based on Norway's much-admired management of its oil wealth. The fund's aims are to accumulate oil revenues for future generations, to stabilise the socio-economic development of Kazakhstan and to reduce the country's vulnerability to swings in the price of oil.

Reuters

Black gold

Operational since 2001, the fund has accrued the tidy sum of $2.3 billion. This is one of several steps Kazakhstan has taken in the right direction, according to a report by Svetlana Tsalik, a member of Caspian Revenue Watch, an organisation sponsored by George Soros, a Hungarian-born financier-turned-philanthropist. The organisation seeks to monitor the activities of governments that have benefited from Caspian oil.

What to do with the cash? Unlike Norway, Kazakhstan is underdeveloped and needs to spend money, Mr Soros said at a presentation of the report in Almaty on June 2nd. Some new wealth should be used now, he said, on priorities such as education. One of the report's recommendations is that the government should consult the Kazakh people about what the oil money urgently needs to be spent on. To date, however, the idea of involving the public in anything related to the presidential fund has been disregarded.

It is difficult even to gauge what money actually goes into the presidential fund, and when. Lack of transparency is thus one of the fund's problems. “An oil fund can have an excellent investment strategy, yet still disappear in an instant if it is completely subordinated to a president,” said Miss Tsalik. The fund lacks proper checks and balances, and the few channels of accountability that do exist lead to President Nazarbaev.

But the flaws in the fund can also be traced back to the reluctance of oil companies working in the Caspian Sea to publish the terms of their contracts with Kazakhstan. This has created the widespread impression that the state is not getting its due. Kazakh officials fret over contracts signed when the government did not have the necessary experience to deal with savvy oil-company representatives. Kazakhstan's lack of democracy and its newspapers' lack of freedom to report on the activities of the fund are other barriers that Kazakhs have to overcome if they are to turn their oil into prosperity for all.

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India

An echo of terrorism

Jun 12th 2003 | DELHI
From The Economist print edition

A martyr is declared in Punjab

FOR most Indians, Jarnail Singh Bhindranwale was a terrorist. But to Sikhs he was a powerful leader who led a violent campaign for an independent state called Khalistan. A Sikh-run Khalistan, which would have replaced the north Indian state of Punjab, remains no more than a dream, but Bhindranwale is enough of a folk hero for him to have been declared a "martyr of Sikh history" on June 6th, the 19th anniversary of his death.

Bhindranwale built a fortress at the Golden Temple, the Sikhs' holiest shrine in the Punjab city of Amritsar, and was killed in June 1984 when Indira Gandhi, then prime minister, sent troops to oust him. The ceremony to confirm him as a martyr was carried out by Sikh leaders at the Akal Takht, the religion's Golden Temple headquarters. Its roots lay in a campaign by the Akali Dal, the Sikhs' main political party. It has not been opposed by India's governing Bharatiya Janata Party (BJP). Though he was regarded as a terrorist, the Akali Dal is part of the ruling coalition.

So is Sikh terrorism about to erupt again in Punjab, adding to India's separatist unrest in Kashmir and its north-eastern states? The short-term answer is no. But the sight of politicians using the Sikh religion for political ends brings uncomfortable reminders of the events that led to Bhindranwale's emergence from obscurity and to a period of violence that claimed some 35,000 lives—including that of Mrs Gandhi, killed by her Sikh guards, seemingly in revenge for the attack on the Golden Temple.

There is currently no unrest in Punjab, one of India's most successful states. But agricultural growth has slowed since the "green revolution" 25 years ago. Many young people are without jobs and have become disenchanted with the government, an echo of the feeling among youths in the 1980s who were captivated by Bhindranwale's dream of Khalistan.

K.P.S. Gill, a police chief (and a Sikh), who fought the militants at the beginning of the 1990s, says "mischief is afoot once more" in Punjab politics. This is a reference to actions by the Akali Dal, which ran Punjab's state government until March last year. The party persuaded the BJP government in 2001 to remove 150 Sikhs living abroad from a blacklist. Several have returned to Punjab, among them Wassan Singh Zaffarwal, who ran the Khalistan Commando Force, and Jagjit Singh Chauhan, who set up a Khalistan government-in-exile in London. Mr Chauhan, now in his 70s, runs a village hospital, but, along with others, still campaigns for Khalistan, though only, he insists, in "a democratic, constitutional and peaceful way".

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Dowry inflation

A suitable price

Jun 12th 2003
From The Economist print edition

The rising cost of marrying up

INDIA discovered a new heroine last month when Nisha Sharma, a 21-year-old software engineering student, called off her wedding near Delhi after learning that her would-be in-laws were demanding an extra $25,000 dowry payment on her wedding day. Miss Sharma's defiance in the face of an ancient dowry tradition, which has caused the price of a husband to soar—sometimes to as much as $100,000, and often to several times the bride's family's annual income—made her the toast of Indian editorialists and won her newspaper spreads around the world.

Miss Sharma's notoriety may now be fading, but an interesting question remains: why are dowries so high in the first place? Rapid economic growth and modernisation (not to mention the law) should by now be starting to put paid to the dowry system in India much as they did long ago in Europe. But not only has the practice persisted in India, the amounts required to lure a man to the altar have grown far faster than can be explained merely by economic growth.

A new study, by Siwan Anderson, an economist at the University of Tilburg in the Netherlands, offers an answer. It argues that the continuing importance of caste continues to fuel dowry inflation. Economic growth has not only made average wealth rise, but, crucially, has increased the range of inequality of income within each caste.

Despite attempts to chip away at caste, through job-promotion programmes and greater access to education, it remains a powerful source of status. So, argues the paper, women are still competing for the limited pool of men in castes above their own. Marrying up, in status rather than in wealth, is still something India's brides are willing to pay for. An increasing income spread makes it possible for the price of a scarce resource, in this case a high-caste husband, to be bid up much higher than it would if incomes were more uniform.

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Israel and the Palestinians

And it all goes up in flames

Jun 12th 2003 | JERUSALEM
From The Economist print edition

AFP

Has Israel's attempt to kill a Hamas political leader killed the hopes for peace?

Get article background

ONLY last week, on June 4th, Mahmoud Abbas and Ariel Sharon agreed gingerly at Aqaba to walk the first steps of the road map. Seven days later, on June 11th, the road was flooded in blood. A suicide bomber had blown up a bus in Jerusalem, killing 16 people. In retaliation, Israel carried out of a series of attacks on Gaza from helicopter gunships, killing at least 14 people, perhaps five of them Hamas men.

The road started to buckle when Palestinian militants, in a concerted ambush on an Israeli army post in Gaza on June 8th, killed four Israeli soldiers. Then, on June 10th in Gaza, the Israelis fired five rockets at the car of Abdel-Aziz Rantisi, a paediatrician and top Hamas politician.

Dr Rantisi leapt out in time but three Palestinians, including a woman and child, were killed. In visceral response, Hamas pitched missiles at an Israeli town on Gaza's northern border. Israel then killed three civilians in a rocket attack on Jabalia, the most densely-peopled refugee camp in the occupied territories. Thus the violence continued, reaching its bloodiest point so far with the Jerusalem bus bomb.

“The Israelis may have aimed at Rantisi, but they hit Abbas,” said a Hamas man. George Bush seems to have understood this. He vigorously condemned the bus bombing. But, earlier, the president had responded swiftly to the attempted assassination, rebuking Israel. A statement from his spokesman said that he was “deeply troubled” by the timing, fearing it would undermine Palestinian efforts to bring an end to terrorism. Mr Bush himself said that he did not believe that such attacks “help the Israeli security”. Indeed not.

Mr Abbas called on America to prevent a repetition of assassination bids which, he said, were “intended to obstruct and sabotage the political process”. The prime minister needs all the help he can get. Since the summit at Aqaba, he has been under a torrent of Palestinian criticism for repeating the American script that denounces terrorism against Israelis, while not reaffirming Palestinian lore that says peace will come only with Israel's withdrawal from the land it occupied in the 1967 war, including East Jerusalem, and a “just” resolution of the refugee question.

It was in response to those omissions that Hamas called off talks with the Palestinian Authority on

arranging a ceasefire. In jittery defence, Mr Abbas held a press conference on June 9th to state his commitment to Jerusalem, the refugees and the release of Palestinian prisoners. He also urged Hamas to resume the ceasefire talks. His strategy is, or was, to persuade the militias to end the “armed *intifada*”. In return, he hoped to get American assurances that Israel would pull out of re-occupied Palestinian areas, end the assassinations of Palestinian leaders and generally relax the occupation. There had been one or two faint signals that Hamas might respond—until the attack on Dr Rantisi showed up the weakness of Mr Abbas's clout with the Americans, let alone Israel.

In awful warning, Hamas announced that it was activating its cells to strike at the Israelis everywhere. A day later it claimed the Jerusalem bombing, in revenge for the attack on Dr Rantisi. Other militias have called on Mr Abbas and his new Palestinian government to resign. Even Fatah, Mr Abbas's own movement, joined in a declaration that rejected the conclusions of the Aqaba summit in favour of “national unity, resistance and the *intifada*”.

In the face of unwonted, and apparently unexpected, censure from America, Israel thrashed around to come up with an explanation. Mr Sharon told the newspaper *Yedioth Ahronoth* that his government, unlike its predecessors, would not “compromise on its determination to fight terror... while it is trying to negotiate peace.”

Defence officials said that Dr Rantisi had been on Israel's list of targets for some time, and that there was intelligence evidence pointing to his involvement in Hamas's terrorist activities, including responsibility for the ambush on the soldiers in Gaza, which had been claimed by the al-Aqsa Brigades, a militia linked to Fatah, as well as by Hamas and Islamic Jihad. If the Palestinian prime minister would not take on Dr Rantisi, said Ehud Olmert, the deputy prime minister and a close Sharon ally, then Israel must.

But the understanding at Aqaba had been that Mr Abbas and his team would need some time to organise their security forces, and to try to reach a ceasefire agreement with Hamas and other groups, before gradually taking back responsibility for security in the Palestinian areas. Mr Abbas, and apparently Mr Bush, felt they had an implicit commitment that Israel would largely desist from offensive operations during this period of grace.

A group of senior reserve officers had planned to publish large newspaper advertisements on June 11th supporting Mr Sharon's new openness to negotiations, and praising him for beginning to dismantle settlement outposts. After the assassination bid, they cancelled the ads. “We thought he'd changed,” said one former brigadier. "But we were wrong. Sharon stays the same as he always was. He is not prepared to move towards peace.”

Another reading is that Mr Sharon may indeed be willing to move some way towards peace, but approved the hit on Dr Rantisi to please his restless right. The removal by the army of a dozen or so “unauthorised outposts” this week triggered furious accusations from the settlement lobby that Mr Sharon was “surrendering to terror”. So he set out to prove that he was not. And now terror has struck.

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The Kurds in northern Iraq

What's happened to our cash?

Jun 12th 2003 | ARBIL
From The Economist print edition

A quarrel between the Kurds and the UN over unspent oil revenue

Get article background

REINTEGRATING their region into the rest of the country was never going to be easy for Iraq's Kurds. Having enjoyed 12 years of self-rule, freedom from persecution by Saddam Hussein, and relative economic prosperity, they accepted that there would be a price to pay for the removal of the hated Iraqi dictator. At the same time, they very much hoped that their support for his ousting, combined with a sensibly moderate political agenda that respected Iraq's territorial integrity, would not go unrewarded.

But as the Americans dither over Iraq's post-war political settlement, growing numbers of Kurds in the overwhelmingly pro-western north are worried that their concerns are being overlooked. Historically familiar mutterings of a sell-out are beginning to be heard.

The chief cause for concern is the terms on which UN sanctions against Iraq are being ended. Resolution 1483, adopted by the Security Council on May 22nd, provided for the phasing out of the oil-for-food programme within six months, and handed total control of Iraq's oil resources to American and British administrators. Any outstanding money from the oil-for-food programme is to be transferred into a national Development Fund for Iraq. This would include the separate escrow account into which the 13% of oil revenues specifically earmarked for the Kurdish regions were deposited.

Kurdish leaders, who say they were not consulted by their “allies” in the drafting of the resolution, are alarmed that there is no provision in the resolution for reimbursing the $3.7 billion in unspent oil revenue that rests in their account. This is money the Kurds can ill afford to lose. Because of the disruption of the oil-for-food programme shortly before the start of the war, economic life in the north is grinding to a halt.

Vital customs revenues from border trade with Turkey and Iran have all but dried up. Tens of thousands of civil servants, as well as the Kurdish *peshmerga* soldiers, went unpaid for months. Unemployment is rising fast. Aware of the gravity of the economic situation in the north, America last week provided $30m in cash to help pay key government workers, such as teachers and hospital staff.

Hoshyar Zebari, of the Kurdistan Democratic Party, asks why Kurds, who fought alongside Americans in the war, should now be made to pay for UN inefficiency and the manipulation of the oil-for-food programme by the former Baathist regime. The programme at first acted as a safety-net for the Kurds, who had been reeling under the double whammy of international sanctions on Iraq and internal sanctions imposed on their area from Baghdad. But there were soon complaints that most of the revenues were still languishing in the UN's bank account.

This, the Kurds say, was due partly to the UN's inefficiency and lack of transparency (to put it charitably) in approving projects, partly to Baghdad's blocking tactics. The UN argues that it had to deal with the Iraqi government as the recognised sovereign power. The result, according to the Kurds, was that health and engineering projects intended for the north remained at the drawing-board stage, some of them for as long as five years.

An official in the UN office that deals with the oil-for food programme says that, of the $3.7 billion in the Kurdish escrow account, $1.7 billion has been allocated to specific projects but remains unspent, while a further $2 billion is unallocated and unspent. A senior British official at the UN tried to allay Kurdish fears about the fate of these unspent revenues. He was only partially successful.

He said that the $1.7 billion was safe. So was the $2 billion, provided the Kurds could come up with

enough projects to absorb the money in the next six months. That is a taxing task for a developed country, let alone an area in political and economic limbo. The senior official declined to say what would happen if the Kurds failed to spend the $2 billion.

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Communists v clerics in Iraq

Battle of the beards

Jun 12th 2003 | BAGHDAD
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Iraq's few Communists are among the brave to stand up to the ayatollahs

ARE Communists coming to America's rescue? While Iraq's other secular parties cosy up to the clerics, the Workers' Communist Party of Iraq (WCP) is struggling to halt Iraq's slide into an Islamic state. It holds coming-out parties for Baghdad girls who shed the veil, and, with reports of women being mugged, it has opened a refuge on the top floor of a Tigris-side bank repossessed by the proletariat. "Congratulations," says Yanar Muhammad, a self-professed "ex-Muslim" and founder of the WCP's Women's Freedom in Iraq Organisation, as she hugs her latest recruit to the barehead brigade.

In the charred shell of the bank below, party cadres plot their return to Al-Thoura, Baghdad's sprawling Shia shantytown, once their heartland but now the bridgehead of an Islamic state. A comrade with a huge bush of facial hair proposes Molotov-cocktailing a mosque for each liquor store or cinema torched.

The battle of the beards dates back 45 years. In the 1958 regime-change that ousted the monarchy, Marx not the mullahs was Iraqi Shias' source of emulation. The ayatollahs fought back, but without great success. Now, the failure of America's regime-change to impose order—which a report by the International Crisis Group describes as "a reckless abdication of the occupying powers' obligation to protect the population"—has sent women scuttling beneath the safety of the veil, or to self-imposed purdah indoors. It has paved the way for vigilantes to enforce patriarchal codes. Girls are pulled out of school, men do the shopping, and wedding parties and cafés are shut down before dusk. Al-Thoura is as tightly veiled as the southern suburbs of Tehran.

Can the Communists' clarion call again strike a chord? Young people are fed up with being told which films they can and cannot watch. Women demand equal inheritance rights and the abolition of laws that sanction "honour" crimes and forbid them from leaving Iraq without a male guardian. In the Baghdad cafés frequented by artists and authors, there is talk of a backlash. "We don't want to replace one totalitarian system with another," says an artist, with a whisky bottle stuffed down his jumper. "Iraqis just need some time to have fun."

The Communists' political muscle is hard to assess. They stood no chance in one-party Baathist Iraq. In the northern haven, the Iraq Communist Party got no more than 2% of the vote in the 1992 parliamentary election, and since then the party has split into three.

Moreover, the ayatollahs have grown so influential in post-Saddam Iraq that even some secular leaders are beating a path to their doors for a blessing. Few politicians dare broach the issue of separating state from religion. And the artist in the café could not have paid for his whisky, had it not been for the rush of commissions for clerical portraits to fill the billboards formerly adorned by Saddam.

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Peacekeeping in Congo

Is protection a mirage?

Jun 12th 2003 | BUNIA
From The Economist print edition

The French troops are a fine force but it is not clear what they will be doing

Get article background

AS THE gun-smoke cleared, the victorious Congolese rebels turned to encounter a terrible new enemy. With grim precision, 50 French soldiers advanced down Bunia's main street on June 7th, tropical sunlight glinting on their chic matching shades and first-world weaponry. Aghast, the militiamen stood aside.

Reuters

A big gun and a small mandate

Or perhaps they were simply exhausted, having just fought a six-hour battle in the derelict centre of Congo's north-eastern capital. As the battle raged, a storm of bullets had swept the main UN compound, trapping thousands of refugees inside. A dozen civilians had been killed or wounded in the crossfire; 20km (12 miles) from town, 80 villagers had been reported massacred. The French troops, who had arrived in Bunia the day before, supposedly to prevent such slaughter, were confined to barracks, without orders to intervene.

The advance guard of a 1,400-strong European-led rapid-reaction force, backed by air support and heavy armour, the French have a UN mandate to defend Bunia's population from the tribal war raging in Congo's north-eastern Ituri province. Their deployment follows the failure of 700 Uruguayan UN peacekeepers to intervene in an on-off, month-long fight for the town, which has seen hundreds of civilians massacred, and 250,000 displaced.

The mostly-French force was raised at the request of the UN's secretary-general, after the Uruguayans' plight had led to UN reports that Ituri's war could be genocide. Yet the force has no plans to venture outside Bunia, where most of the killing occurs. Nor will it demilitarise the town, essential if the militia war is to be ended. Nor will it intervene in militia fights, the invariable prelude to civilian massacres. By September 1st, the force will leave, replaced by 3,000 Bangladeshis.

And yet, modest as it is, the intervention represents the first ripple of serious western attention to Congo's war, a complicated four-and-a-half-year calamity that is believed to have claimed between 3.1m and 4.7m lives, more than any other conflict since the second world war. At its height, the war involved nine national armies. Most have now withdrawn, but in eastern Congo, a vast and always incendiary region, a dozen small wars are blazing.

Rwanda, Uganda and Congo's own government fuel these fires. Through a shifting throng of local

proxies, they are contesting the great lakes and green hills of eastern Congo, and the fabled mineral wealth they conceal. The conflict in Ituri—home to one of the world's biggest gold deposits—is just one, especially virulent, flame in this inferno.

It was kindled three years ago, when Uganda's efforts to control the area through the minority Hema tribe enraged the Lendu majority. As Uganda proceeded to back the militias of one side, then the other, the killing spiralled out of control. At least 50,000 people have been butchered. The region's culture is decomposing: ritual cannibalism is endemic among many militias, as traditional charms against bullets no longer suffice.

Ituri's war, lacking the state mechanisms that allowed Rwanda's Hutu regime to murder 800,000 people, most of them Tutsis, in 1994, is not likely to develop into huge-scale genocide. But it does feature scores of village genocides. One such was the month-long massacre of 1,000 Hemas in Nyakunde district, 50km south of Bunia, last September. With no peacekeepers trapped in Nyakunde, as the Uruguayans were trapped and humiliated in Bunia, the UN seemed hardly to notice.

The latest intervention in Bunia is basically designed to protect UN staff, plus the 20,000 or so civilians still living in the town. This is rather less than the UN promised Iturians in April, when it vowed to safeguard a rigorous local peacemaking intiative, the Ituri Pacification Commission. To the UN's surprise, Ituri's armed groups all agreed to the commission, promising to be cantoned and disarmed. But, without any military muscle to enforce its orders, it is now a distant dream.

The UN has asked the main militia group to leave Bunia, but has been told no. Will the French make it go? Since the humiliation of the UN mission in Ituri, it is becoming fashionable to say that the war has no military solution. This is eyewash, as Britain's tiny, determined, intervention in Sierra Leone suggests. By enforcing the peace, British troops allowed aid to flow, and persuaded thousands of destitute rebels to hand in their guns. If the UN kept its promise to the peace commission, Ituri's fighters might do the same. Until then, the Mirage fighters flying over Bunia will be truer to their name than their potential.

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Zimbabwean arrests

At the receiving end of Mugabe's punch

Jun 12th 2003
From The Economist print edition

Morgan Tsvangirai is now doubly charged with treason

Get article background

HE MUST be getting used to it by now. On June 10th, Morgan Tsvangirai, Zimbabwe's opposition leader, appeared in court to be formally charged with treason for a second time. This time, the charge relates to his having tried to organise demonstrations of the sort that the government recently made illegal without police permission, which is rarely granted. The judge ordered that he be held in one of Harare's cells for a month, which will make it harder for him to organise peaceful expressions of popular discontent. His deputy, Welshman Ncube, was also arrested this week, but was released shortly after Mr Tsvangirai's appearance in court.

Mr Tsvangirai is already part-way through another treason trial. One of President Robert Mugabe's lavishly-paid agents claims that he plotted to assassinate the old man. Even Zimbabwe's tainted legal system might have difficulty convicting Mr Tsvangirai on the basis of such evidence. He was released on bail, perhaps in the hope that he would skip the country. Instead, he stayed, and organised a series of general strikes, including one that shut down most of Zimbabwe's remaining businesses last week.

AFP

Back inside

He also tried to organise street protests, but these were greeted by hovering military helicopters and armoured vehicles with machineguns mounted on rotating turrets. Despite this show of force, several thousand people took to the streets, and were duly tear-gassed and beaten. More than 800 were arrested, according to the Movement for Democratic Change (MDC), the main opposition party. Suspected ringleaders were rounded up and tortured. At least two people died.

The government threatened that it would revoke the licences of businesses that observed the MDC's call to shut down last week. Some shopkeepers pulled down their shutters because they feared that Mr Mugabe's heavies would start shooting. Factory owners protest that they could hardly have kept the production lines humming when none of their employees arrived to man them. But cancelling the licences of people who do not support him might enable Mr Mugabe to award more licences to his cronies.

In the past, his arbitrary style of government has enriched many within the ruling party, ZANU-PF. Party bigwigs have used their contacts to exploit the rigged exchange rate, or grabbed shares of farms and businesses confiscated from the regime's opponents. But even some of the least scrupulous ZANU hacks are starting to worry that if things carry on this way, there will be no Zimbabwean economy left for them to plunder.

There are growing signs that rage at the regime could evolve into violent unrest. The half or so of the population who are short of food are, perhaps, too weak to revolt. But urban Zimbabweans, furious at the hasty erosion of their living standards, may not be cowed for ever. As Mr Mugabe finds it ever harder to pay his various and sometimes mutually antagonistic security forces (the army, the police and the irregular militia), the danger of a coup grows daily. Alternatively, Zimbabwe might simply collapse.

The government of South Africa, Zimbabwe's powerful neighbour, does not want a failed state on its doorstep, so it is urging talks between the MDC and the government. The MDC insists that such negotiations can be useful only if they lead to a fresh round of elections, which, unlike last year's presidential poll, would have to be free and fair.

Mr Mugabe, however, says that he cannot step down while his people are “disunited”. In a rare interview, he told South African state television this week that he is determined to battle on. “As long as there is that fight, I am for a fight. And I can still punch,” he said. Indeed.

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Kenya's lost general

A case of mistaken identity

Jun 12th 2003 | NAIROBI
From The Economist print edition

A hero of the independence war turns out not to be

A STOOPED 72-year-old man arrived at Nairobi's Jomo Kenyatta International Airport on May 30th to a hero's welcome. Women ululated, dancers gyrated, and a member of Kenya's parliament declared it “the greatest day for this country since independence”. General Stanley Mathenge, a lost, legendary nationalist leader, had finally returned home. Or had he?

General Mathenge was one of the leaders of the Mau-Mau rebellion, the war Kenyan guerrillas waged against the British colonialists and local loyalists throughout the 1950s. After the rebellion collapsed, Mr Mathenge vanished into the wilderness near the Ethiopian border. He was long presumed dead.

Then, two years ago, a respected Kenyan journalist tracked down Lemma Ayanu, a farmer in Ethiopia, who claimed to be the long-lost general. Mr Mathenge's wife travelled to see him, and declared that the man was indeed her husband. So the Kenyan government invited Mr Ayanu to return “home” to be guest of honor at Kenya's 40th Independence Day celebrations.

As soon as the supposed general got off the plane, it was clear something was amiss. Looking haggard and confused, Mr Ayanu began addressing the crowd in Amharic. He seemed to understand neither Swahili nor Kikuyu. He also seemed to be about ten years younger than Mr Mathenge would be, a foot shorter, and without a distinctive scar on his neck. Most tellingly, Mr Ayanu told one of the dignitaries present: “I'm no Kenyan. I'm no Kenyan.”

The press quickly pronounced the poor man a fraud. The Independence Day invitation was hastily withdrawn, and on June 6th Mr Ayanu was bundled out of the back door of the four-star hotel where the government was housing him, and unceremoniously dropped off at the airport. Kenyans wondered how he had taken in so many. But Mr Ayanu was too busy to answer questions. He had to rush home, he said, because it is planting season in Ethiopia.

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Poland and the European Union

Back into the fold

Jun 12th 2003 | BERLIN AND WARSAW
From The Economist print edition

AP

To make its voice heard when it joins the European Union next year, Poland must first reinvigorate itself at home

Get article background

THE Poles proved bolder than the polls had suggested. In a two-day referendum on June 7th and 8th, they voted 77% in favour of joining the European Union next year, and with a respectable turnout of 59%, comfortably above the 50% threshold needed to make the referendum binding.

The Czechs vote on June 13th and 14th. Estonia and Latvia follow in September. Barring a last-minute hitch, that should clear the way for the EU's expansion into central Europe on May 1st next year, adding eight members there plus the Mediterranean islands of Cyprus and Malta.

Until last week the big question overhanging Poland's EU accession was whether enough people would vote to make the referendum valid. Now, attention shifts to how Poland will behave once inside the Union. Its population of almost 40m will dwarf those of the other new members and most of the old ones too. In an enlarged EU of 25 countries, only Britain, France, Germany and Italy will have more votes in the Council of Ministers, the main legislative body. For better or worse, Poland will make its presence felt.

It has done so already in the five-year-long accession negotiations, talking at times as though it was doing the EU a favour by joining. Heather Grabbe, of the Centre for European Reform, a British think-tank, sees problems ahead if Poland goes into the Union with too little long-term strategy and too great an interest in short-term gains. The nightmare scenario, says Ms Grabbe, would be a Poland which was “Spanish on the budget (fighting tooth and nail for every euro), French in defending the common agricultural policy, British in its pro-Americanism, Danish in its Euroscepticism, and Italian in its chaotic public administration.” Poland's politicians and civil servants have a lot more work to do in the coming year, she says, if they are to make their country influential in the EU and not just awkward.

Two things will help decide whether Poland punches above or below its weight in the enlarged EU. The first is the relations it establishes with the leading EU states. The second is the strength and stability of its government at home.

Poland's size and sense of history make it want to be accepted as a “big country” in the EU pecking

order, despite its relative poverty. Its diplomats purse their lips at the idea of being expected to hang around with the rest of the new boys. Poland's first choice of mentor and ally in the EU would probably be Germany, its mighty neighbour, despite the lingering memories of Hitler's war, in which some 6m Poles (including 3m Polish Jews) died.

The chances of a serious partnership with Germany looked very slim indeed even a few weeks ago, when Poland was helping the American war effort in Iraq, while Germany and France were angrily opposing it. But relations are becoming more relaxed again. German officials can understand well enough Poland's difficulty in choosing between America and Europe, given Germany's history, at least until recently, of not wishing to make that same choice.

The big spoiler here may be France, Germany's traditional partner in Europe. French reservations about America go much deeper than Germany's, and France is also more openly snooty towards the EU's new members. It will balk at turning the old Franco-German “motor” of the EU into a three-stroke model incorporating Poland, logical as this might be in geopolitical terms after the EU's enlargement. The one thing that might change French attitudes would be fear of a looser alternative alliance developing between Poland, Germany and Britain in pursuit of more liberal policy goals—the combination that most Poles, and perhaps even most Germans, would prefer, if they had to choose.

An early test of Poland's instincts will come when it lends its voice, as a full voting member, to the EU's long-running argument about farm subsidies; the issue was preoccupying the Union's farm ministers again this week, with efforts being renewed to restart world trade talks. Poland's short-term interests lie in seeing payments to its own farmers raised quickly to current EU norms, rather than slowly (by 2013) as the EU insisted last year. This would be a popular “victory” for any Polish government, given the country's 2m farms.

But the EU's agricultural policy, which directs 40% of all EU budget spending towards farm subsidies, is notorious the world over for its wastefulness. Poland and every other EU country would do much better in the long run from a deep reform that directed money towards the balanced development of rural economies and not into the pockets of farmers who happened to be there. The right option for Poland would be to use its votes to help that reform happen. The wrong option would be to follow the past (and apparently present) example of France, as a big beneficiary of the common agricultural policy, in resisting fundamental change.

Back on the home ranch

Whatever Poland's instincts in Europe, its government will be taken seriously there only if it first proves its strength at home. And here the latest news is less good.

Poland's beleaguered prime minister, Leszek Miller, promptly sought to exploit the encouraging referendum outcome by inviting a parliamentary vote of confidence to be held on June 13th. His government commands only a minority in parliament, and has seen its popularity undermined badly by sleaze allegations and a weak economy. Poland's president, Alexander Kwasniewski, an ex-communist like Mr Miller, would clearly prefer a new prime minister with a parliamentary majority. Mr Kwasniewski believes, rightly, that Poland needs a strong government to push through tough budget reforms before EU entry. The World Bank has calculated that Poland's social-security system consumes 20% of GDP and 45% of public spending, one of highest rates in the industrialised world. Public spending in general is badly managed, services are poor, privatisation has languished, and the tax system is riddled with exemptions.

Hopes for fiscal reform and deficit-cutting rested mainly on Mr Miller's finance minister, Grzegorz Kolodko—until he quit on June 11th, outmanoeuvred by his rival, Jerzy Hausner, the economics minister, who wants a looser fiscal policy to stimulate demand. Mr Kolodko's replacement is Andrzej Raczko, a former deputy finance minister. He will have his work cut out, while the government lasts, finding a policy that pleases Mr Hausner, and the EU, and the financial markets too.

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Britain and the euro

What a pity. What a relief

Jun 12th 2003 | BRUSSELS
From The Economist print edition

Many Europeans are glad that Britain is hesitating over the euro

BRITAIN'S decision to stay out of Europe's single currency, at least for now, was not front-page news in the rest of Europe. The decision was, after all, hardly a surprise. Most commentators interpreted it as further evidence of Britain's deep ambivalence towards the “European project”.

Although the European authorities were careful not to express much of an opinion on the British government's wait-and-see verdict, there does seem to be genuine regret that Britain is not joining. The fact that London, Europe's major financial centre, will stay outside the euro zone is an irritation. A British decision to sign up would be seen as a powerful vote of confidence in the euro.

Conversely, the decision to stay out raises a question-mark over the European Union's official view that the single currency is both historically inevitable and unarguably beneficial for all who adopt it. Morale in the euro zone has increased in recent months, as the new currency has risen against the dollar.

Yet there is the uncomfortable knowledge that economic growth in much of the euro area is feeble and that the “stability and growth pact”, whose fiscal rules are meant to bind all members of the single currency, is falling apart. Some European politicians had hoped that a British decision to join might provide the occasion for a wholesale renegotiation of the dreaded pact.

On the other hand, in some respects the managers of the euro zone have reason to be grateful that Britain is keeping out. Their decision-making, hard enough as it is, would become even trickier if Britain adopted the single currency. The single biggest difficulty in the euro zone at the moment is that interest rates have been consistently too high for Germany, whose economy needs a boost.

But if Britain took up the euro, there would now be stronger pressure to raise rates from their current level to take account of relatively high inflation in what would be the euro area's second-biggest economy. Similarly, British financial circumstances would argue for a relaxation or a scrapping of the euro zone's fiscal rules, since Britain has a low national debt, a comparatively well-funded pension system and badly wants to spend more on public services.

The fiscal situation in other parts of the euro zone, where national debts are higher and the pensions crisis much worse, is very different. One-size-fits-all policies are hard enough to sustain as it is, without the British complicating matters further. Perhaps the next time Europe's finance ministers meet, they should pass a vote of thanks to Britain's chancellor, Gordon Brown.

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NATO

The alliance tries to strike back

Jun 12th 2003
From The Economist print edition

Putting NATO together again after Iraq

Get article background

WHEN the cold war ended, NATO looked like an alliance in need of a mission. Since then, even its best opportunities to define one have come and gone. The Kosovo episode persuaded many in Washington that “war by committee” was inadvisable. An offer of support to America after September 11th was largely snubbed. An upbeat summit in Prague last year seemed to galvanise the alliance—until the debacle over Iraq, a “near-death experience” for NATO, according to America's ambassador to it. A meeting of defence ministers in Brussels this week (their foreign counterparts convened in Madrid last week) may help to revive some of the springiness of Prague.

AP

Try to remember your flag

A decision made there by the 19 existing members to open NATO's doors to seven new countries made all the headlines. Just as important, they promised to procure bits of military kit, either individually or in groups. Failure to fulfil previous vows to do so has contributed to the yawning technological gap between America's armed forces and those of its European allies (though the gap within Europe is also glaring), making it ever tougher for them to fight together. The Prague commitments are, according to some, a last chance for many Europeans to prove their military seriousness and secure the concomitant influence in Washington. Emyr Jones Parry, Britain's man at NATO, says that if the pledges are broken, those “who prefer to avoid a multilateral solution will say, ‘I told you so'. ”

Since Prague, there has been some action but also a lot of the usual talk. Still, the effort to make the alliance into a modern war-fighting outfit was given a small fillip by agreement on the shape of its NATO response force (NRF). The force is an American idea, partly designed to concentrate European minds on their military shortfalls. It will be smaller and sharper than the EU's similar-sounding outfit, able to deploy more quickly and fight more aggressively. The EU force will act when NATO chooses not to; missions to Africa are an obvious example. The two are thus supposed to complement each other, though they may end up calling on the same assets. An initial version of the NRF may be up and running later this year.

Will NATO'S members ever agree on what to do with it? Debate about Iraq may not rage as it once did, but it still rumbles on. There have been smaller squabbles over a plan to streamline the alliance's old

military command structure, making it more nimble and stripping out several of the current HQs, to the chagrin of some of the host countries, such as Spain and Greece. A new “command transformation” in Virginia is designed to help close that technological gap.

The strange thing is that, even amid rumours of its slow demise, NATO is as active as ever. This summer it will undertake its first operation outside Europe, when it assumes control of the international force in Afghanistan. It will also help Poland with its peacekeeping job in Iraq (and many other NATO countries will have boots on Mesopotamian soil). It is still busy in the Balkans. Yet none of this will silence those voices who argue that NATO is too unwieldy to fight global terrorism; or that it will one day be eclipsed by the EU's nascent security effort; or that it is destined to remain America's cleaning lady.

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Jürgen Möllemann

A mysterious death

Jun 12th 2003 | BERLIN
From The Economist print edition

Why did one of Germany's most controversial politicians die?

MURDER, suicide or accident? A week after the death in a parachute fall of Jürgen Möllemann, one of Germany's most irrepressible and controversial politicians, rumours are swirling. The former government minister and federal vice-chancellor, a master self-publicist who had recently fallen from political grace as a leading liberal, would have wanted it no other way: he adored the limelight.

On June 5th, the 57-year-old Mr Möllemann, a former paratrooper, organised a parachute jump with friends, as he had done hundreds of times before. The weather was fine. Mr Möllemann, looking relaxed, was one of the last to leave the aircraft. Everything was going to plan when his parachute suddenly became detached from his body, and he plunged some 1,000 metres (3,300 feet) to the ground.

Minutes before, parliament had lifted Mr Möllemann's immunity from prosecution, giving police the go-ahead for a swoop into his affairs in 13 places in Germany, Luxembourg, Liechtenstein and Spain. He was being investigated for fraud, illegal party financing, and tax evasion in connection with an anti-Israeli leaflet he had distributed during last year's election.

The source of the finance remains unclear. Mr Möllemann said he had provided *euro*840,000 ($981,000) out of his own pocket. Others suspect secret backing from one of the many Arab contacts he had fostered during 20 years as chairman of the German-Arab Society and through his consultancy firm specialising in the Middle East. The furore over the leaflet, after earlier allegations of anti-Semitism, led three months ago to his being hounded out of the Free Democratic Party, of which he had been deputy leader.

Could this, along with the threatened revelation of some new scandal, have prompted him to commit suicide? The police seem to think so. They have found no evidence to suggest murder or an accident.

Yet most of Mr Möllemann's family and friends do not believe he took his own life. He was happily married, rich and left no suicide note. He seemed in good spirits and was well prepared for the lifting of his parliamentary immunity, which he knew was imminent. Though his expulsion from the Free Democrats was a bitter blow, he was busy planning to found a populist party and to write a second book of political revelations.

The cause of Mr Möllemann's death may never be cleared up. Some see a parallel with the case of Uwe Barschel, the 43-year-old Christian Democratic premier of Schleswig-Holstein found dead in his bath in a Geneva hotel, fully dressed in suit and tie, in 1987. No evidence of murder or suicide was ever found. Like Mr Möllemann, Barschel generated intrigue, vendettas and rumours of shady business deals. He also had links with the Middle East and was suspected of involvement in secret arms deals. Indeed, some have fancifully begun to wonder if there could even be a link between the two deaths.

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Protest in France

A government assailed

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Anti-reform demonstrations are becoming more violent

AP

Can the fiery mob shake the state pillars?

IT PROMISES to be a long, hot summer. As France's prime minister, Jean-Pierre Raffarin, was busy on June 10th presenting his case for reforming his country's demographically challenged pensions system, police were fighting to stop a small but violent mob in Paris's Place de la Concorde from reaching the parliament building just across the river Seine. On the same day, fierce clashes and strikes spattered the country. The next day another mob tried to bash its way into the Paris headquarters of the ruling Union for a Popular Movement (UMP).

France, it seems, is in the grip of a *petite révolution*. Cool-headed Mr Raffarin seems determined not to retreat, at least on pensions. He thinks the protest is a paroxysm of rage that merely reveals the underlying weakness of his opponents.

That infuriates France's unions. The residue of the hard left is also angry. It is doing all it can to be obstructive. The parliament's 22 Communists (out of 577 deputies in all) have laid down an impressive 7,000 amendments to the proposed pensions laws. The Socialists, of whom there are 141, managed a more modest 2,900. The debate could drag on for weeks. Too bad, Mr Raffarin thinks, so long as the law is passed. He talks of a need for “demographic lucidity”.

Strikes—many of them by workers who will not be affected by the planned pension reforms—and demonstrations have paralysed the country. In some cities uncollected rubbish is piling up in stinking heaps. The country's important pre-university Baccalauréat exam began on June 12th amid threats that the invigilators would refuse to turn up. Something has to give. So far, it seems unlikely to be Mr Raffarin.

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Turkey's army

Is it a waning influence?

Jun 12th 2003 | ISTANBUL
From The Economist print edition

Turkey's generals are still a brake on reform. But that may not last

IF THE government that took office in November were to have had its way easily, Turkey's parliament, where it enjoys an absolute majority, would months ago have approved an array of new laws to bring the country closer towards achieving its long-held ambition of joining the European Union. The “mini democratisation package”, the sixth in a series of reform bills, would let international monitors scrutinise general elections; let private radio and television channels broadcast in Kurdish; remove the armed forces from the board of Turkey's broadcasting watchdog; and scrap Article 8 of the anti-terror law, which bans “separatist propaganda” and has justified the jailing of thousands of politicians, journalists and campaigners over the years.

AP

Guardians of the secular state

But Turkey's meddlesome generals, who recently blocked a UN plan to reunite Cyprus, have been saying no. They have argued, as usual, that “Turkey's special circumstances” mean that governments should always be empowered to take extraordinary measures to guard against “those who wish to undermine the country's territorial unity” (code for Kurds) or against others who might want to reverse “80 years of secular rule” (ie, Islamists).

Things may at last, however, be changing. The country's prime minister, Tayyip Erdogan, his foreign minister, Abdullah Gul, and his justice minister, Cemil Cicek, have recently steeled themselves to stand up to the men in uniform. The elected politicians now promise that the reforms, originally due to pass in April, will be enacted in time for a grand EU summit in Greece on June 20th—without even being brought before the National Security Council, where the top generals bang their fists.

Whoever comes out on top—the generals or the politicians—will greatly affect the government's credibility at home and abroad. It is not an exaggeration to say that the future of Turkish democracy is at stake. If the reforms go through and are actually implemented, the Turks hope they will soon be given a date for starting formal negotiations to join the EU.

For many of the generals, the changes would hurt. They would plainly have to take orders from civilians. They would have to allow the military budget to be publicly scrutinised; no one, outside the generals' circle, knows where the money goes. And they would have to keep out of politics for good.

They are unlikely to submit to political authority graciously. “The armed forces' strategy is to undermine and embarrass the [ruling] Justice and Development Party,” says Umit Cizre Sakallioglu, an authority on

the army. The top soldiers, who zealously guard Turkey's secular tradition, have never concealed their contempt for Mr Erdogan, who, partly thanks to their pressure, was previously ousted as mayor of Istanbul and put briefly behind bars for publicly reciting a poem that allegedly tried to incite religious rebellion.

True, the prime minister originally went into politics under the banner of an overtly Islamist and anti-western party. But he says he long ago changed his views; among other matters, he switched to support for joining the EU. Religion and politics, he now says, should be kept separate. And in a gesture to the generals, he agreed this week to remove a clause from his reforms that would have allowed small mosques to be built within residential compounds.

Since forming Turkey's first single-party government in 15 years, Mr Erdogan and his party have done little to bolster the generals' thesis that they have a secret Islamist agenda. Mr Erdogan's resounding success at the polls was the clearest signal yet that his compatriots, most of whom share the generals' secular leanings, do not think he is bent on an Islamic takeover. With a 15-year-old separatist rebellion in the Kurdish-dominated south-east having virtually ended since the capture in 1999 of the Kurds' rebel chief, Abdullah Ocalan, most Turks are also less receptive to the generals' warnings against separatism.

They haven't surrendered, though

Still, the generals seem determined to play the nationalist (ie, anti-Kurdish) card by attacking the government over its proposed reforms. But this time the generals, who have thrice seized power directly in the past four decades and who squeezed the country's first Islamist-led government out of power in 1997, may have picked the wrong fight. One reason is that an overwhelming majority of Turks want their country to join the EU—and realise that the proposed reforms would help them achieve that goal.

A growing number of commentators are starting to ask whether the generals also want Turkey to join the EU. One columnist, Cuneyt Ulsever of the mass-circulation *Hurriyet*, has even said that General Tuncer Kilinc, the secretary-general of the National Security Council, should resign because of his hostile remarks about the EU. Not too long ago, Mr Ulsever might have lost his job or been censored.

On the other side of the debate, however, some ardently secular-minded writers have accused General Hilmi Ozkok, the unusually mild-mannered chief of the general staff, of being too soft on the government. A left-wing daily, *Cumhuriyet*, quoting sources in the army, reports that a group of hot-headed junior officers agree with that view. This has sparked murmurs of the possibility of yet another coup.

The generals, it seems, are rattled, especially since their old friends in the United States have joined the ranks of their critics—largely because of American irritation at the Turkish generals' failure to lobby publicly for a bill quashed by parliament on March 1st that would have let American troops attack Iraq from Turkish soil. Many Turkish officers who fought against Kurdish rebels in the south-east were further dismayed when the Americans dissuaded them from going into Iraq themselves in order to have a say in its future.

Now on the defensive, various generals are trying to calm things down. “Don't even mention the word coup,” huffs General Ozkok. “There are no hawks or doves, no young officers or old ones,” he says. “We support EU membership but feel we should join the Union as equals, so long as our national unity is not at risk.”

The army still tops the polls as Turkey's most trusted institution—partly because it has long reflected public opinion. But this time it may not be doing so. The generals' influence may be starting to wane—to the satisfaction, it seems, of a growing number of Turks.

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Charlemagne

The great debate

Jun 12th 2003
From The Economist print edition

The EU's constitutional convention was to bring the Union closer to the people. It has done the opposite

Get article background

YOU have to hand it to Valéry Giscard d'Estaing. The chairman of the European Union's constitutional convention has proved that even at the age of 77 he is a master politician. Using a mixture of regal hauteur, bullying, negotiation and selective listening, he now looks likely to force the disputatious rabble on the convention floor to agree to a single text for an EU constitution, which will be presented at a grand summit meeting in Greece on June 20th.

Technically, the convention could then be deemed a success. But in one crucial respect it is already a gloomy failure. For it has failed to achieve its proclaimed objective of sparking a wide public debate and making the Union more comprehensible to José Público. In the EU's announcement in December 2001 that it was to set up a constitutional convention, its very first declared aim was that “European institutions must be brought closer to their citizens”. The convention's debate should be “broadly based and involve all citizens”. The main debates have indeed been held in public and were open to any passing journalist or somnolent student. But there has been barely a flicker of discussion among ordinary people across the continent. As the convention delegates joke: “We said we would have a public debate but instead we've had a debate in public.”

A recent Spanish opinion poll found that a good 90% of Spaniards were unaware of the convention's existence and only 1% knew its goal was to write a constitution for the EU—and by extension for Spaniards. When Mr Giscard d'Estaing published his first full draft, the event was not even mentioned in *Bild*, Germany's biggest-circulation newspaper. The British tabloids, by contrast, have run front-page stories claiming that a “blueprint for tyranny” is being drawn up in Brussels.

Many Europeans know so little about the EU that the convention's debates would mean nothing to them. A poll taken for Britain's Foreign Office in 2001 discovered that a quarter of Britons did not know that their country was actually a member of the European Union, and 7% thought that the United States was in it. In Germany, a founder member of the Union whose serious papers devote acres of space to EU affairs, another recent poll found that 31% of the public had never heard of the European Commission, the EU's most important institution.

In theory, the new constitution will improve matters. One of its aims is to simplify and democratise the EU. Many different treaties are being rolled into a single text. The language is to become simpler: European directives will now be called European laws. The directly elected European Parliament will be involved in more decisions that were once confined to the more secretive Council of Ministers. But the appearance of simplicity is largely an illusion. Almost everywhere you turn in the new treaty, baffling new legal procedures and language spring from the text.

Take the attempt to decide whether EU countries will forge a common foreign policy by majority vote or by unanimity. At present it is apparently proposed that the EU's members could unanimously decide to take a decision by a majority vote. As for the election of members of the European Parliament, this will be decided on the basis of “degressive proportionality”. Even where the constitution makes an apparently unambiguous claim, the reality is almost invariably more complicated. So, for instance, the EU will have legislative powers to pursue “economic and social cohesion” across the Union. But leaf forward a couple of hundred pages to part three of the constitution and you discover that this apparently sweeping power is tightly defined to cover only regional-aid policies.

This failure to connect with people is due not just to the opacity of the constitution's legal structure or the obscurity of its language. The widespread ignorance of the basic functions of the Union revealed by opinion polls shows that most voters are completely indifferent to the EU, even though, in most of its countries, it already makes more than half the laws. The reaction of most conventioneers is to shrug this off and plough ahead. Some argue that a further centralisation of powers in the EU, combined with more powers for the European Parliament, will in time create genuine pan-European politics.

Waiting for a European demos

That is highly dubious. If voters simply made a cold analysis of a politician's views and then voted accordingly, Europe's democratic deficit could be made good quite easily through institutional changes. In fact, all national democracies in Europe rely on a sense of community, a shared culture and, almost always, a common language. This allows voters to act as much more than desiccated policy-analysis machines. They respond to politicians by asking “Do I like this person?” or “Do I trust him?” As soon as a British, Italian or French politician opens his mouth, his compatriots will know many things about him: his social class, region, personal style, and so on. Such cues, so important in making personal and political judgments, barely operate across Europe's linguistic and cultural barriers.

The European Union is a success, despite this lack of a shared political identity, because for most of its history it has been concerned above all with relatively apolitical matters of economic management: the creation of an internal market, the management of competition policy, and so forth. But over the past decade the EU has moved decisively into new and much more sensitive areas—foreign policy, fiscal and monetary policy, immigration. This process will be accelerated by the new constitution, which entrenches or expands the EU's powers in all these areas. But though the convention has proved all too capable of giving the European Union more powers, it has signally failed to show it can create a genuine European debate. As a result, far from narrowing that democratic deficit, the European convention may well make it wider.

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Britain and the euro

No again

Jun 12th 2003
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Reuters

But the economics is moving towards yes

Get article background

IN 1997, just after Labour came to power, Gordon Brown, the chancellor of the exchequer, addressed Parliament on the question of joining the euro. He said four of his five economic tests for joining had not been met—the only one passed was the impact of euro membership on the City of London—but that there were obvious economic benefits to joining. The government, he said, should “prepare intensively” so that Britain could be in a position to sign up “early in the next Parliament”. About now, in other words.

Instead of that marriage of true currencies, Mr Brown was in Parliament on June 9th, addressing MPs once more on joining the euro. He said four of his five economic tests for joining had not been met—the only one passed was the impact of euro membership on the City of London—but that there were obvious economic benefits to joining. But he didn't give a date for when it might happen.

Enthusiasts for joining the euro, led by Tony Blair, fanned out this week to argue that the chancellor's second verdict, unlike his first one, could lead to a referendum later in this Parliament. But Mr Brown has fought off demands that he hold a further assessment next year. Instead he has merely promised to review the case for another assessment in his budget next spring. That could be little more than a year from the next election if it is held, as most people expect, in mid-2005. Not much will have changed by then to alter the Treasury's judgment. A referendum this side of the election looks only a remote possibility.

But unlike the fate of the first Treasury report on the euro six years ago, the chances of a referendum early in the next Parliament are high. For one thing, Mr Blair would be much more willing to take a political risk after winning a third election victory. Indeed it might be riskier for his credibility if he did not then finally put the issue to a vote. Just as important, the detailed judgments of the Treasury's voluminous analysis suggest that a third verdict in two or three years' time could be yes.

In 1997, Mr Brown was able to talk about the potential benefits of joining the euro to Britain's trade position only in general terms. Now the Treasury has come up with some hard estimates. Building on new research about the impact of currency unions on trade, it says that, if Britain joined the single currency, over 30 years its trade with the euro area could be 50% higher than if it kept the pound. This in turn could push up Britain's underlying growth rate over the same period from 2.5% to 2.75% a year:

a substantial increase given the notorious difficulty in raising the trend rate of growth. These estimates could prove exaggerated since they are based mainly on the experience of small economies in currency unions. What matters politically is that Mr Brown chose to highlight them, spelling out the gain in higher living standards to households.

The barriers to realising such gains remain the same as in 1997. The Treasury finds that Britain has still not converged sufficiently with the euro area to allow early membership. And it is not flexible enough to deal with economic shocks without the buffer of an independent exchange rate and monetary policy. The failure to pass the “convergence” and “flexibility” tests means that Britain has still not demonstrated the “sustainable and durable” convergence needed to live comfortably with interest rates set in Frankfurt by the European Central Bank.

But the convergence barrier is lower than it was when Mr Brown delivered his first verdict six years ago. The chancellor said there had been “significant progress in achieving cyclical convergence”: the economy is now marching more in step with that of the euro area. The gap between short-term interest rates has narrowed from almost four percentage points to less than two. The difference between output gaps—a measure of the cyclical position of an economy—has also narrowed.

Mr Brown also noted improvement on the flexibility test, which in essence asks whether wages can adjust promptly if necessary to restore competitiveness. At present, the pound can depreciate if the economy becomes uncompetitive, but inside the euro area, wages will have to take the strain. The Treasury points to the big fall in unemployment since 1997 without a rise in wage pressure as evidence that the economy had become more flexible.

These improvements were not sufficient to satisfy Mr Brown that the two first and most crucial tests have been met for now. But there are hints in the Treasury's analysis that suggest that both could be met in a subsequent assessment in two or three years' time. And in that case, the other two failed tests—the impact on investment and the overall effect on growth and jobs—would also be passed.

The main stumbling-block to passing the convergence test is Britain's boom-and-bust housing market. The worry is that short-term interest rates set by the European Central Bank for the euro area will have a disproportionate effect on British homebuyers because much more of their borrowing is on a variable basis rather than the fixed rates common in Europe. So the Treasury is investigating whether reforms could shift mortgage loans to longer terms, as is also the case in America. Mr Brown also wants to tackle the shortage of new homes, which exacerbates the instability of the housing market. Already there are new legislative proposals in the pipeline to hack away at planning restrictions that constrain development. But Gideon Amos, director of the Town and Country Planning Association, says that a Treasury commitment to impose its will on the system “is potentially more radical than any of the measures”.

Such reforms will take time but that is less of a problem than it might seem: even if Britain were to vote in 2006 to join the euro, entry would not take place for a year or so. In any case, the housing market could go into a long hibernation after the boom of the last few years.

The Treasury is also exploring an important new plan to use fiscal policy to counter the greater economic volatility of the economy once it joins the euro. In the 1997 assessment this notion barely warranted a mention. Now it has been elevated to form a major part of the assessment. Mr Brown wants to turn the clock back and to reinvent contra-cyclical fiscal demand management, which was used enthusiastically in the 1950s and 1960s but abandoned thereafter because changes in public spending or taxes were often too late, so they exaggerated rather than dampened cyclical movements in the economy. The Treasury thinks that problem can be overcome if the policy is implemented more swiftly and people are better-informed about it. Economists at Barclays Capital regard the policy proposal as “the most significant revelation” from the Treasury's 2,000 pages of analysis.

Poison pill defence?

Designing the economics of this package may be easier than selling it politically. People don't like the idea of the government dictating housing development in their back yards. Householders will not appreciate extra taxes on house-buying, even if they are in the good cause of making the economy less volatile. Nor will unions like the idea of greater regional wage flexibility in the public sector—another proposed reform—since some people are bound to get lower wages than others.

Quite apart from these political difficulties, it will be difficult to sustain a case for joining the euro if the big economies like Germany continue to languish. Certainly there is enough in the Treasury's assessment to provide cover for another postponement of a decision to join.

More likely, however, the euro area will stage a recovery, which would both lead to greater convergence with Britain and make it easier to sell euro membership. The nastier bits of the chancellor's proposed reforms to the housing market could be toned down. A positive verdict could then provide a platform for a possible referendum early in the next Parliament. And if the voters say no? The government can always adopt the European approach to referendums: holding them again until they get the right answer.

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History lesson

What if Britain had joined in 1999?

Jun 12th 2003
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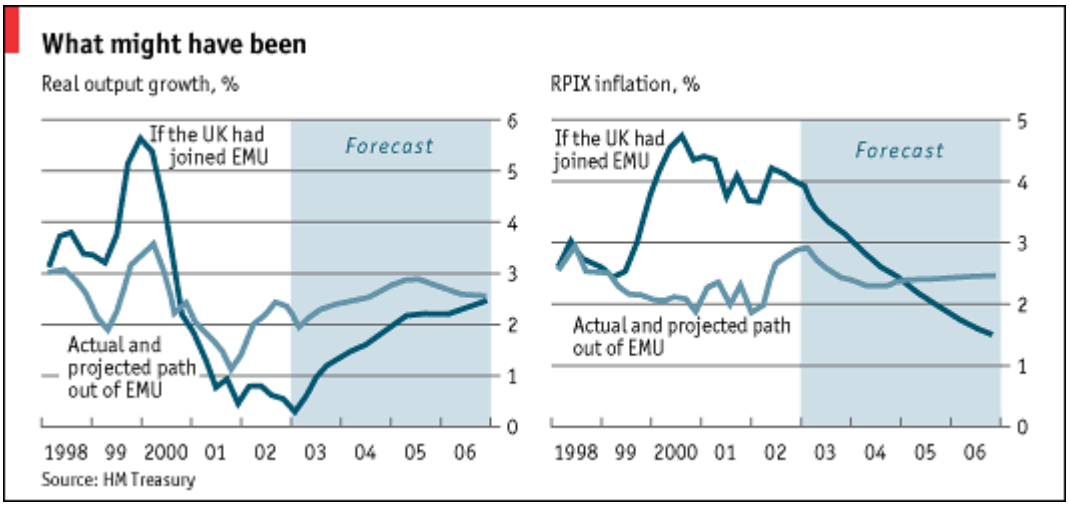

The Treasury's cautionary tale

Get article background

COUNTERFACTUAL history is a fashionable discipline. Now the Treasury has pitched in with its contribution to the genre. It rewinds the clock to Gordon Brown's first verdict in 1997 and changes the answer to yes. So Britain joins the euro with the other 11 founder members at the start of 1999. How would the economy have fared inside rather than outside the euro area?

Initially, the champagne corks would have been popping. Interest rates would have dropped by four percentage points to the lower level set in the euro area. The stimulus to the economy would have pushed growth in 2000 up to a heady 5.5%.

But the millennium party would have generated a long hangover. Excess demand would have pushed inflation up to nearly 5% and it would have stayed high over the past three years. This would have made the economy less and less competitive.

Outside the euro area, a loss of competitiveness can be quickly regained by a fall in the exchange rate. Inside, it has to be grindingly restored through a protracted period of lower inflation and slower growth.

The Treasury's counterfactual history is self-serving: it vindicates the decision Gordon Brown took in 1997. But it also illustrates why it is so important to ensure that the economy is as convergent as possible with the euro area before signing up to membership. The less that interest rates have to fall, the smaller the shock.

The simulation also demonstrates why it is so important to join at the right exchange rate. Once Britain gives up its independent monetary policy, adjustment to shocks will occur through changes in the real exchange rate—the market rate adjusted for prices at home and in Europe. If Britain were to join at too high a market rate this would require a subsequent painful adjustment of lower inflation to bring the real exchange rate into line.

The Treasury published an independent estimate of a sustainable exchange rate for joining the euro: Simon Wren-Lewis, an economist at Exeter Unversity, says around *euro*1.37. Until its recent fall the pound was much more expensive, but now, at *euro*1.42, it is close.

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Football finances

Beckonomics

Jun 12th 2003
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Superstars aside, the transfer market is in terminal decline

Get article background

RUMOURS that David Beckham, the pin-up and Manchester United star, may be sold to a foreign football club sent many tongues wagging this week. None, however, spoke with the grace—or authority—of Silvio Berlusconi. The Italian premier, who doubles as president of AC Milan, took time off from meetings with Ariel Sharon to declare that “There are many better ways of spending money that has been earned with great sacrifices other than hiring Mr Beckham.”

Mr Berlusconi may well be right. David Beckham's abilities and marketing clout notwithstanding, it is becoming increasingly difficult to justify spending £20m ($32m) to £30m—the rumoured asking price—on any footballer. The market for players is crashing to earth, and there will soon be bargains available for the patient.

It was not always thus. During the 1990s, the rising price of football players seemed like a law of nature. Between 1995 and 2001, the amount spent by English clubs increased from £213m to £423m, with just under half the money going overseas. This boom had two causes. First, a 1995 ruling by the European Court of Justice allowed players to move more freely between clubs. Second, the television licensing market grew rapidly thanks to the spread of pay-TV. Assuming that players would be worth exponentially greater sums in future years, and reluctant to see them depart for nothing at the end of their contracts, football clubs eagerly signed long-term deals at high prices.

But demand from couch potatoes turned out to be less elastic than the clubs thought, and a correction set in. By the 2001-02 season, transfer spending was down to around £400m. Since then the market has, in the words of a football agent, “fallen off a cliff”. Dan Jones, who follows football finances for Deloitte & Touche Sport, reckons that spending will drop to mid-1990s levels in the next few years. The Premier League is trying to buck up the market—it recently allowed clubs to stagger transfer fees over the life of a player's contract.

But such ploys are unlikely to succeed. Players (including quite good ones) are now flooding the market, their clubs having failed to find buyers for them while they were still in contract. When this summer's trading window opened, a record 586 professional players—out of a total body of less than 2,500—found themselves without an employer. Most will be picked up, but on short-term contracts that contain nasty things like relegation clauses. Gordon Taylor, president of the Professional Footballers' Association, speaks of a “cold wind” that may soon depress wages. Which, for poorer clubs that in the past have lived off selling players to richer ones, is the only good news around.

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Wedding costs

For poorer

Jun 12th 2003
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Marriage is dead. Not so weddings

MARRIAGE isn't what it used to be, says the bus-pass brigade, and this is true. For one thing, fewer people are doing it. Apart from a blip in 2000, when a batch of millennial proposals came to fruition, the number of weddings in England and Wales falls every year. Just under 250,000 people got hitched in 2001, compared with 331,000 in 1990, with first-time marrying couples accounting for most of the decline. More people are living together, even having children out of wedlock.

Yet even as marriage goes out of fashion, weddings are thriving—and becoming more expensive. According to *You and Your Wedding*, which carries out an annual survey, the average price of a do has increased from £10,715 ($17,750) to £15,243 in the past five years. Couples are spending less on hotel receptions (taking advantage of falling prices) but more on everything else, with particularly large increases in frivolities like shoes and jewellery. Spying a seemingly recession-proof business, high-street stalwarts like Debenhams are now trying to muscle in on the trade.

Why are young couples splashing out? These are the same people, remember, who cannot get on the bottom rung of the property ladder, who must start saving money now if they expect to eat in their dotage. Part of the reason is the deregulation of civil weddings. In the bad old days, church-shy couples had to endure ceremonies that were nasty, brutish, and short, so they didn't make much of a fuss. Now they can get married in ritzy surroundings, and since 1995, a steadily increasing number (20% at last count) have done so.

Class may also be a factor. As cohabitation, once the preserve of the middle-classes, spreads down the social scale, so the average income of marrying couples rises. But a more important clue comes from the rising age of couples. The average first-time bride and groom were 27.7 and 29.7 years old in 2001—up three years since 1991. Middle-class women used to delay childbirth to have a career. Now they seem to be delaying marriage as well. Marco Francesconi, a demographer at Essex University, reckons they are trying to raise their value on the marriage market: “we all have an option value attached to ourselves, and we know that it will go up if we make certain investments,” he says.

In this light, a pricey wedding makes a lot of sense. What better way to prove you have made it than by hosting a lavish event—and what better way to prevent your beau from straying than by asking them to put down a massive non-refundable deposit on the marriage?

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Occupational pensions

Copycat

Jun 12th 2003
From The Economist print edition

Will the American system of pension insurance work for Britain?

AS MODELS go, it is an odd choice. On June 11th the government announced plans to introduce a compulsory insurance scheme for companies' defined-benefit pension plans, which guarantee employees pensions related to their final salaries. The new scheme is modelled on America's Pension Benefit Guaranty Corporation (PBGC), a quasi-governmental agency set up 30 years ago which insures basic pensions provisions for about 44m American workers. At the end of March, the PBGC had a deficit of $5.4 billion.

Grey fury

The government proposes to set up a pension protection fund (PPF) for the 18,000-or-so defined-benefit plans that are still open, financed by a fixed levy on companies and a premium supposed to reflect different funds' different levels of risk. (The larger the gap between assets and liabilities, the riskier the fund.) When a company goes bust the PPF will ensure that pensioners receive their pension in full and those still in work get 90% of the pension they have built up so far.

Under these proposals, solvent employers winding up their underfunded defined-benefit schemes would have to compensate their workers fully. (Some companies shutting their pension plans last year walked away from some of their obligations.) The government plans to introduce a new pensions regulator to replace the Occupational Pensions Regulatory Authority. And to lessen the burden for employers, pensions will no longer have to be indexed directly to inflation.

The government claims to have learned from the American experience after dispatching two senior civil servants across the Atlantic to study the PBGC. It also says that the PBGC is still 90% funded and its finances can recover.

Yet it risks running into the same problems. A safety net for pensions can create moral hazard by encouraging fund managers to take excessive risks. Healthy companies with well-managed funds have to subsidise troubled firms with underfunded pension schemes: US Airways, for instance, America's seventh biggest airline, was able to re-emerge from bankruptcy only because the PBGC took over its pension plan on April 1st.

And the levy to fund the scheme is an additional burden on companies in tough times. American companies pay $19 a year per employee for fully-funded schemes and substantially more for underfunded ones. But the levy is not high enough to cover the demands on the PBGC—hence the huge

deficit.

Unsurprisingly, companies gave the proposal a rather cool reception. “This goes some way, but does not eliminate my concerns,” says Chris Lewin, head of British pensions at Unilever. Companies are particularly worried about moral hazard, subsidising bad apples and how much the levy will be. Moreover, they are disappointed that the government will not be insurer of last resort of the protection fund. Meanwhile unions are angry about the proposed easing of indexing pensions to inflation, which may hurt workers if inflation rises. Despite intending to help workers and employers, the government managed to make both unhappy.

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Scottish Enterprise

Wrong target

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From The Economist print edition

The boss of Scottish Enterprise is quitting, but he's not the problem

SCOTTISH ENTERPRISE, the main economic development agency north of the border, used to be much envied for its success in cornering big slices of inward investment and running pioneering regeneration schemes. Now it is under attack from Scottish politicians and newspapers, and its boss, Robert Crawford, has announced that he is quitting.

Mr Crawford's problem is that, when he joined in 2000, the inward investment boom was busting. New jobs from foreign direct investment are down from around 15,000 a year in the late 1990s to around 6,000 last year. Mr Crawford saw that coming, cut the agency's workforce (hence, perhaps, the leaks to newspapers from disgruntled employees) and turned the agency's attention towards doing more for companies already in Scotland. His new strategy was to encourage more people to start their own businesses, to help existing firms to expand by, for instance, speeding up the spread of broadband, and to seek out new technologies which might spawn businesses.

But there are three drawbacks to this approach. First, if it does generate jobs, it does so slowly. Second, it does not produce big shiny factories for politicians to preen themselves in front of. Third, it competes with the private sector. For example, Thus, a telecoms business, complains that a plan to spend £30m on low-cost broadband access for business parks breaches EU rules because it competes with private provision. The EU is investigating.

Mr Crawford's biggest problem, however, is with his political masters. The Labour-Liberal Democrat coalition that runs Scotland constantly has to explain what it is doing to improve Scotland's poor economic growth rate—1.5% a year in 1997-2002, compared with 2.5% for Britain as a whole. There is a feeling that Scottish Enterprise has not delivered.

Since Scottish Enterprise is not charged with boosting growth, but with fulfilling myriad micro-targets, such as numbers of women and poor people to be helped to start a business, it seems unfair to blame Mr Crawford for this broader failure. Rather than jibing at the outfit's boss, Scottish politicians might do better to ask whether Scottish Enterprise is ever likely to make a difference—and whether its £460m budget would be better spent on lowering the higher business taxes which handicap Scottish companies.

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Criminal justice

Police and polis

Jun 12th 2003
From The Economist print edition

The Home Secretary now wants the people to decide

AN ODD thing happened on June 11th. David Blunkett—targets fanatic, über-centraliser, scourge of the judiciary—said that the government ought to loosen its grip over policing and criminal justice. In a pamphlet that trotted quickly through the history of thought on the relationship of the individual to the state, from the Athenian *polis* through to Bernard Crick, waving at Rousseau, Hobbes, Mill, Marx, Charles Taylor and Isaiah Berlin on the way, the home secretary suggested that local police commanders would be given more autonomy and (perhaps) placed under the control of elected police boards. The Crown Prosecution Service should become more visible and more accountable, too—something like America's glamorous district attorneys.

All this is intended to help people feel more connected to the police and the law. Mr Blunkett shares a fear common among politicians these days—that people have become disconnected from the institutions that are supposed to serve them, and, as a result, are vulnerable to right-wing populists bearing hard-line policies. Certainly, Home Office research suggests that people don't know whom the police are accountable to. And attempts to make policing more transparent (by introducing performance targets, for example) have served merely to annoy coppers.

But there are a few problems with Mr Blunkett's plans. To begin with, it's not clear that the Home Office is prepared to let go control of police funding. If it doesn't, it's hard to see how police can be made accountable to local people. Then there's the apathy problem: for hard-pressed voters, selecting a police board from a range of anonymous figures may be a decision too far. Another solution, pushed by Policy Exchange, a think-tank, which favours a more radical localism including decentralising police funding, would be to place the police under the control of local councils. This has the advantage that councillors are known, and already have jurisdiction over things like noisy pubs.

There is a problem, too, with the vague proposal to “boost the profile of senior prosecutors, so that they command the sort of standing they do in the United States”. In America, where most district attorneys are elected, the electorate tends to pass judgment not so much on their record on the boring bread-and-butter cases that make up most of their job, but on the high-profile cases that make it on to the evening news. As John Kaye, a New Jersey prosecutor, explains, “it doesn't matter how successful you've been. One bad case and you're dead.”

The problem Mr Blunkett identifies—of people's sense of disconnection from politics—is a serious one. One of the reasons for it is the weakness of local government, whose financial powers have been greatly reduced over the past 20 years. Setting up new elected bodies without financial power will not do much to solve it.

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Sexually transmitted diseases

Out of Africa

Jun 12th 2003
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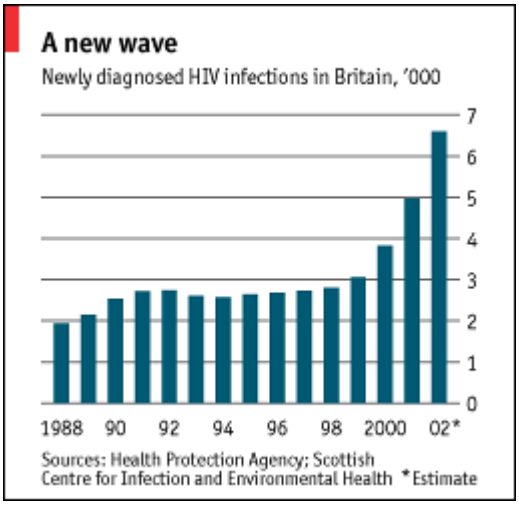
How HIV infection rates are rocketing, and government policies aren't helping



IN THE 1980s, at the height of the AIDS panic, the disease was widely expected to decimate western society. It didn't, and people stopped panicking. Now the rate of new infections is more than three times as high as it was then (see chart).

Why? Partly because, after the initial panic over AIDS shocked people into safe sex, risky behaviour is back in fashion. But it is also because of rising numbers of African asylum-seekers, which were up from 18,000 in 2000 to 30,000 last year—a third of the total, up from a fifth. Last year, an estimated 3,200 HIV infections were newly diagnosed among Africans in Britain, 50% more than in the previous year and almost half of the total number of new diagnoses.

The high infection rate among Africans is changing the pattern, as well as the rate, of HIV infection in Britain. It used to be a predominantly gay plague. Now it is becoming a heterosexual scourge as well, as it is in Africa. That's mostly because Africans are skewing the figures; among whites, sex between men is still the commonest route of transmission.

Given the rise in imported infections, some people are arguing for mandatory HIV testing for asylum-seekers and other immigrants. The government is said to be looking into this politically explosive topic, but a report on HIV and other STIs (sexually transmitted infections) published by the House of Commons health select committee on June 11th dismisses the idea of mandatory testing, because of worries that it might drive the HIV epidemic underground.

Indeed, getting Africans in Britain to come in for HIV testing is already an enormous problem. Many turn up for testing only when their disease is well advanced, partly because of fears that they will be rumbled by the Home Office if they do. Once inside the system, language and cultural barriers can make treatment difficult. In London and other large cities, African community groups help out. But as Max Sesay, head of the African HIV Policy Network in London, points out, the government's policy of dispersing asylum-seekers across the country has sent many HIV-positive African migrants to far-flung counties where the necessary medical and social expertise is thin on the ground.

Is the government to blame for other aspects of this epidemic of STIs? The Commons committee thinks so, despite the national sexual health strategy implemented last year which is supposed to boost prevention and improve access to services. Its report criticises the length of time people have to wait for testing and treatment—usually around 10-12 days. That means the diseases are not just harder to treat, but also more likely to spread. The committee recommends that the government set a target of 48 hours for access to care. Too few posts for sexual health specialists and the dilapidated state of many of the country's genito-urinary-medicine clinics are also sources of concern. But doctors suspect that the government prefers to spend on more socially-acceptable diseases, such as cancer and diabetes.

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Bagehot

Body double

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Tony Blair and Gordon Brown are friends again. Really

WHEN the ancient Romans wanted to know what was going to happen, they called on some rather specialised priests, known as *haruspices*, to examine the entrails of a slaughtered animal. We've come a long way since then.

These days, we look to “body language” for the answers. Forget the 18 studies and 2,000-odd pages prepared by the eager beavers at the Treasury to support the Chancellor's widely-predicted “not yet” statement to the Commons this week. If you really want to know whether and when Britain is going into the euro, check out whether Tony Blair crosses his legs when Gordon Brown is speaking or whether Gordon looks out confidently at the audience when Tony is in full flight. If either man doodles or shuffles papers while the other is in action, it's all still to play for. Or something like that.

At a Blair-Brown press conference intended to demonstrate their unity the day after the chancellor had explained why Britain's economy wasn't ready to throw in its lot with the eurozone, at least half the questions were about relations between the two men. At one point, the prime minister was asked whether he agreed with Matthew Parris, a columnist in the *Times*, that “they often hate each other, always love each other and both need each other. Their relationship is complicated, violent and strong”. Mr Blair replied (a touch bitchily, given Mr Parris's open homosexuality), “I think that probably tells you more about Matthew than us.”

For what it's worth, Bagehot divines a distinct improvement in the central relationship of British politics. Although the wrangling over the euro has been intense and protracted, just by spending much more time than usual in each other's company, without the presence of advisers, Mr Blair and Mr Brown must have been reminded of each other's qualities. The compromise they have come up with may be unsatisfactory to zealots on either side, but they can live with it, and they have convinced themselves that it is right for the country.

The chancellor sees himself as still in sole charge of the process determining Britain's euro entry. He remains the keeper of the five tests and he alone will judge how much progress is made towards reducing those impediments to structural convergence he has identified. He can also argue with some justification that the greater stability he wants to bring about in the housing market and the greater flexibility he wants to see in public-sector wage-fixing are worth achieving in themselves.

Crucially, while the prime minister's trust ratings have collapsed, Mr Brown retains a greater degree of public confidence than any other major political figure. According to the latest poll from YouGov, 55% would back Mr Brown's judgment on the euro compared with only 12% for Tony Blair. The chancellor is still credited with running a strong economy, while faith in Mr Blair has been weakened by Iraq's missing weapons of mass destruction. The upshot is that Mr Brown felt relaxed enough to save Mr Blair's face by preserving the notional possibility of a euro referendum before the next election, while knowing that, in reality, the matter is closed.

But for the prime minister, the outcome is also quite satisfactory. There is now a timetable of sorts for a referendum. Mr Brown is now willing to quantify in generous terms the potential economic, as opposed to the merely political, advantages of joining the euro. And he has committed himself to honing the economy in specific ways for euro entry. Despairing europhiles who groan that the necessary structural reforms are the work of decades have misread the chancellor's intentions. Although he would never admit it, the logic of Mr Brown's position is that he now thinks that eventual membership of the euro is inevitable and that he must therefore prepare accordingly.

In the short-term, what is most gratifying to Mr Blair is Mr Brown's evident desire to help build what they call “the patriotic case for Europe”. There is much about the European Union that is not to the chancellor's liking, but he hates being painted in Tory Eurosceptic colours and, moreover, he has convinced himself that Britain is “winning the intellectual argument” in favour of the kind of outward-looking, flexible and enterprising Europe he favours.

Want a fight?

Six years ago, after the last statement on the euro, promises on all sides to continue talking positively about joining were quickly forgotten. There is, however, a good chance that history won't repeat itself. If opinion is to be turned on the euro in good time for a referendum—2006 or 2007 are possibilities—the campaign must start soon. The government has been further galvanised by the Tories' decision, bolstered by their powerful newspaper allies, to lead the charge against the forthcoming European constitution. Everyone agrees that it is no longer enough for the prime minister or the foreign secretary to make the occasional Euro-friendly speech from the political safety of some foreign capital. Ministers must go out and fight.

While the Conservative leader, Iain Duncan Smith, is walking with a new spring in his step, confident that most voters are as hostile to further European integration as he is, Mr Blair and Mr Brown are equally certain that he has boxed himself into a position they can portray as wanting to quit the European Union entirely. That, of course, is not official Conservative policy—the party is groping its way to advocating the kind of “variable geometry” Europe that was fashionable a decade ago—but Mr Duncan Smith, the old Maastricht treaty rebel, is an obsessive who in the past has argued that leaving Europe would be better than accepting any further loss of sovereignty. It is Mr Duncan Smith's misfortune to have helped reunite the most formidable double act in politics.

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A midsummer night's dream

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Life in the Nordic countries has been quietly idyllic. But closer integration with Europe, immigration and welfare reforms may make it less so, says Adam Roberts

NEXT week 24m Swedes, Danes, Norwegians, Finns and Icelanders will celebrate the summer solstice, a time of midnight sun. On the longest night of the year Swedes traditionally dance around a maypole, Danes light great fires on beaches, Norwegians take their sailing boats to the fjords, and people everywhere move to their cottages in the woods, on the coast or in the mountains. One Finn calls it “a time of leaving cities, drinking, making love, drowning and bonfires”. It is a night of exuberant pagan Nordic self-assertion.

A pan-Nordic identity is built on a common culture, geography, history, ethnicity, love of nature and a shared Scandinavian language (except in Finland). Those roots go a long way back. The Kalmar union of the kingdoms of Norway, Denmark and Sweden, signed in 1397, lasted more than a century. Each country was once ruled, at least in part, by a Nordic neighbour (except Denmark, where the ruler was Germany). Sweden's national anthem does not mention Sweden at all but refers to “Norden”, the region. The intertwined national and Nordic identity is reflected in the flags of the five countries: each has its own distinguishing colours, but they all share the design of a cross on a plain background.

But all five countries can trace long individual national histories too. Nearly a millennium ago, Snorre, a Norseman, described the different strengths as fighters of Swedes, Danes and Norwegians. As states, three of them are young: Norway won independence from Sweden only in 1905; Finland got it from Russia after the first world war; Iceland from Denmark towards the end of the second one. Sweden, Denmark and Norway are all rather fond of their low-key monarchies, whereas the other two are proudly republican.

Now the Nordic countries are being asked to adopt a third identity: a European one. Finland hurried into the warm embrace of Europe, currency and all, as soon as the Soviet threat next door had been removed. Two others, Sweden and Denmark, are members of the European Union, but remain undecided on the single currency. The remaining two, Norway and Iceland, have so far refused to join the EU. All four are worried about losing sovereignty and economic control. But, cautiously, they all seem to be edging closer, and are trying to define their places in Europe. As a Danish academic, Lykke Friis, puts it: “All Nordic countries are struggling to find a credible fit between their national identity and the EU...this fit is especially difficult because Nordic identity is ‘about being better than Europe’”. For ‘better than Europe’, read richer than many of their European neighbours, endowed with enviable welfare systems and enjoying comparative political calm.

Identity inside the Nordic countries was built mainly on a shared history and complete ethnic

homogeneity. Their inhabitants were the fair-haired, blue-eyed descendants of Norse farmers, fishermen and traders. In 1951 the author of a British report on Scandinavia wrote that “no alien stock” had touched this part of the world. But that is changing fast. The streets of Stockholm or Copenhagen today are full of brown-skinned, black-haired immigrants from all over Asia, Europe, Latin America and Africa. Oslo has its “Little Karachi”, and in one part of Malmo in southern Sweden immigrants make up 90% of the population. In Sweden as a whole, one in four people is foreign-born or of foreign parentage. In Denmark and Norway the inflow of foreigners has also increased, spawning anti-immigrant political parties and strict new laws to keep incomers out. To a large extent, the Nordic countries' continued prosperity and political calm will depend on how well they succeed in integrating the new arrivals.

Added to these two external pressures on the old Nordic identity is a third, internal one. In all five countries life expectancy is remarkably high and birth rates are low, so the populations are ageing. A post-war baby-boom generation is now ready to retire, collect benefits from generous welfare states and make use of the excellent hospitals, clinics and home-care facilities on offer. At the same time the pool of working-age taxpayers is shrinking and resistance to high taxes is growing. The remarkably successful welfare-state system that developed after the second world war is getting squeezed.

Membership of:

	EU	Euro area	NATO	EEA*
Denmark	Yes	No	Yes	Yes
Finland	Yes	Yes	No	Yes
Iceland	No	No	Yes	Yes
Norway	No	No	Yes	Yes
Sweden	Yes	No	No	Yes

*European Economic Area

This survey will ask whether these three big challenges to the Nordic countries—Europe, immigration and pressure on the welfare state—are fundamentally changing the identity of its people. In one way, the answer is clearly no: a core part of the identity of the Nordic people is pragmatism, which has enabled them to cope with momentous changes in the past and will do so again. That British report of half a century ago gave warning that: “The Scandinavian states can no longer consider themselves in a peaceful backwater, unaffected by the swift stream of events which bears others remorselessly along.” At that point, Iceland had recently won its independence, Finland was paying reparations to Russia for fighting it, the Danes and Norwegians were coping with the aftermath from Nazi rule and the Swedes were trying to find an international role. They were hardly quiet times.

Since then the Nordic states have managed to swim in cold waters remarkably well. To be a citizen of one of them today is to be more assured of wealth, political stability, generous welfare, low crime and a good life than in most other countries. In international comparisons, one of the Nordic five regularly comes off best. Finns are the least corrupt people anywhere; Norwegians enjoy the best standard of living; the Finnish economy is the most competitive after America; the Nordics as a group are the happiest in their jobs, and most generous with foreign aid; Nordic women enjoy more equal treatment with men than those anywhere else; and so on. One veteran Finnish commentator sums it up crisply: “We live today in idyllic circumstances in terms of security, living standards and domestic politics; in a way it is unbelievable.” But can this tolerant, rich and happy dream continue?

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Edging closer

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Relations with the EU are warming a little

Why Norway and Iceland haven't joined the EU

AS YOU travel around the Nordic countries, the money in your wallet tells its own story. Europhile Finns were delighted to be among the first wave of EU member countries to adopt the single currency, so you need euros to pay for your sauna or your plate of crayfish in Helsinki. The Danes, who have been in the European Union since 1973, narrowly turned down membership of the single currency in a referendum in September 2000, but the Danish krone is closely pegged to the euro, and euro notes and coins flowing over the border from Germany are widely accepted in shops and restaurants. So Danes are already getting used to the new currency, and polls show that two-thirds of them are ready to adopt it.

The picture is less clear in Sweden, which has been a member of the EU since 1995 but seems as reluctant as the British to embrace the common currency. If the Swedes vote yes in a referendum on September 14th, meatballs and aquavit in Stockholm will be sold for euros as early as 2006; but that remains a big if. The prime minister, Goran Persson, is leading the yes camp against a motley crew of sceptics. But despite a Swedish tendency to agree that those in authority usually know best, voters so far seem unconvinced.

Compared with the Norwegians, however, the Swedes look like uncritical Euro-enthusiasts. Norway's government twice applied for membership of the EU, only to be slapped down by oil-rich and fiercely patriotic voters at referendums in 1972 and 1994. The more recent vote proved painfully divisive, so political parties have mostly shunned the issue since. For the moment the Norwegian krone looks safe. Yet eventually even Norwegian Eurosceptics may be persuaded to change their minds. In recent months polls have shown growing support for joining the EU: leaving aside the don't knows, the yes camp is now in a majority.

The price of fish

If Norway were to join, super-sceptical Iceland would be left out alone. The island was originally settled by uppity Viking warriors who wanted to run their own show, and still preserves a strong national pride. But Iceland's main worry is that EU fishing directives would hurt its privately run and flourishing fish industry, which is central to its economy. The country is finding new sources of revenue (such as aluminium smelting and tourism) that might eventually ease its dependence on fish, but not for a while yet. However, if Norway, a rival exporter of fish, were to join the EU and get inside that big market, Iceland might choose to follow suit.

Many on the left of Nordic politics argue that moving closer to Europe would mean losing control over social policies (such as high taxes on alcohol). Soren Wibe, a Social Democrat MP in Sweden and an outspoken leader of the no campaign, says he fears adoption of the euro would eventually lead to a common European fiscal policy, “so we would have to dismantle our welfare state quite a lot.”

Such fears help to explain the persistent Nordic scepticism about wholehearted participation in the EU. One Danish observer of European politics says the aloof Nordics have long felt that they are better off and better run than the average European country, but they do worry about being isolated. The urban elite tend to think that closer ties with Europe make sense, but they must convince their more reluctant compatriots, especially in rural areas. Giving people a direct say can make a difference. For example, many Finns regret that, unlike the Danes, they never got the chance to express their views on the common currency in a referendum.

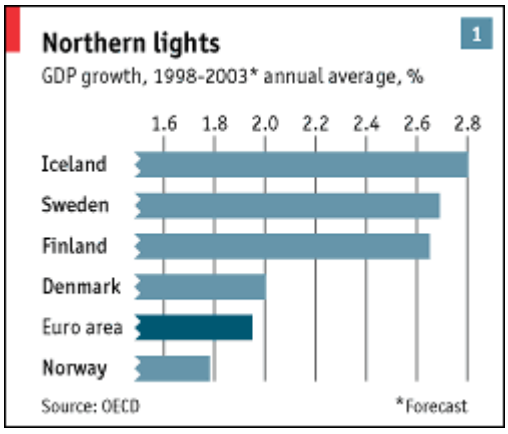
Still, there is no doubt that, of all the Nordic countries, the Finns are the greatest cheerleaders for the EU. A former Finnish prime minister, Aho Esko, talks of a “EU-phoria when Finland was president of the Union”, once his countrymen had finally shaken off their fear that Russia might limit the country's role in Europe. “Compared with 1809, when Russia took control of Finland from Sweden, joining the EU is nothing,” says another Finn.

Paavo Lipponen, the country's prime minister until April this year, believes his country has done well from joining both the union and the euro: Finland “definitely benefits from the single currency. It is stability that has given us such confidence. I don't think [Sweden and Denmark] benefit from staying outside.” He offers Finland's recent economic prosperity as something to bear in mind for those considering euro membership.

The new prime minister, Anneli Jaatteenmaki, is less voluble about things European, and one recent poll suggests that 68% of her countrymen think too much power has been handed to Brussels. But she is unlikely to make big policy changes, not least because her Centre Party must share power with the Europhile Mr Lipponen's Social Democrats.

Meanwhile in both Denmark and Sweden there is a growing consensus that membership of the EU is a good thing, despite some pain for small farmers. The prime ministers of both countries also favour joining the euro. Denmark's Anders Fogh Rasmussen thinks that staying outside the single currency has done his country no economic damage, but politically it has been a problem. “We don't have a seat at the table where decisions are made.” He thinks public opinion is moving towards joining the euro: “People realise that Denmark should be a fully fledged member of the EU to have full influence. And they realise the euro would be more practical.”

But another referendum on adopting the single currency will be tricky, not least because questions loom on the country's other “opt-outs”—from EU treaties on defence, citizenship, and justice and home affairs. Mr Fogh Rasmussen says the government aims to abolish the military opt-out, especially after seeing certain NATO tasks—such as peacekeeping in Macedonia—taken up by the EU. He promises another referendum on Europe in 2004 or 2005, though he has not yet decided if that is the right time for a “big bang” vote to end all remaining opt-outs. Although Danes seem ready for the euro, which they already have in much but name, and for military co-operation, they remain deeply sceptical about common policies on justice and home affairs (which would oblige them to give up some of their anti-immigration laws), and about the more symbolic question of being a citizen of the EU.



If Denmark were yet again to vote against adopting the euro, it might have to consider whether it can remain a member of the EU at all. There is a widespread assumption, both within the country itself and among other EU members, that Denmark's opt-outs are temporary and that the country is on the way to becoming a full and wholehearted member. Another public rejection would scotch that idea and prompt suggestions that Denmark should go for the “Norwegian solution” of associate membership instead.

Meanwhile, though, the Danes can have fun watching the Swedes tie themselves in knots before the referendum on euro membership in September. Swedish voters and politicians, even within government, are deeply divided. For example, although the prime minister is in favour, the trade and industry minister, Leif Pagrotsky, is campaigning for a no vote. He says Sweden's economy is now doing better

than euroland and that “the Euro-sclerosis in Germany is not for us.”

Last November, when the referendum date was announced, polls showed a small majority in favour of joining. But that has since evaporated, just as it did in Denmark three years ago, and now the no camp seems to be in the ascendant. In April the main blue-collar trade-union organisation, LO, took offence at the government's refusal to put aside “buffer funds” to cover social costs arising from the transition, and said it would not campaign in favour.

Much now depends on Mr Persson's own yes campaign, which could swing a lot of undecided voters. He can count on support from pro-euro companies that will provide money for the campaign, and from many male white-collar workers. But he will have to rely mainly on the political case for joining—briefly, that Sweden outside the euro zone lacks influence in Europe—because the economic case is not clear-cut.

Some economists, such as Klas Eklund at Skandinaviska Enskilda Banken, argue that Sweden's economy is in step with Europe, that interest rates set by the European Central Bank would suit it, and that the country would gain from a stable currency, more trade, higher growth and bigger markets within the euro zone. But others insist that gains would be marginal or non-existent. Mr Pagrotsky worries that “Sweden would be less than 3% of the economy of the monetary union, and with a history of high inflation. Why drop the one effective anti-inflation measure?” He believes that Sweden should sign up only if Britain were to join the single currency.

Mr Persson may fear that if he campaigns strongly for a yes vote but is handed a no, his own standing will be damaged. He has been prime minister since 1996, was re-elected last year and is now the only Social Democrat to lead a government in the Nordic region. He may be loth to risk his popularity at the peak of his powers.

Whatever the Swedes decide, the campaign will encourage neighbouring Norway to rethink its position in Europe. Although a Swedish yes on the euro will not automatically help the pro-EU camp in Norway, it will prompt Norwegians to make up their minds. Already polls show that the group of undecided voters is shrinking, with the pro-EU camp picking up support.

One reason why Norwegians may want to consider EU membership anew is the price of food, which thanks to huge tariffs on some imported foodstuffs is one-third higher than in Sweden. Meat in Norway is so expensive that before Christmas families traditionally drive to Sweden to buy festive supplies of pork ribs and steaks. Because of limits on the amount of meat each person can import, children (known as *fleskunger*, or bacon kids) are crammed into the backs of cars to make the trip worthwhile. Norwegians are expected to spend NKr9 billion ($1.3 billion) over the border this year.

But non-membership costs money in other ways too. Norway and Iceland have just been through tough renegotiations with the EU on the terms of their membership of the European Economic Area, which provides for free movement of goods, services, capital and labour between the Union and European countries (other than Switzerland) that have remained outside. From 2004 both countries will pay five times their present membership fee; Norway will also funnel existing bilateral aid for eastern Europe through the EU, so its total transfer to the Union will top NKr1.7 billion a year, a tenfold rise.

Nor is money the only consideration. “As well as paying in, Norway has now adopted an estimated 5,000 EU directives as its own law,” says Jarle Hammerstad of HSH, a business organisation in Oslo. Even Norway's formerly sceptical prime minister, Kjell Magne Bondevik, has recently admitted he feels a “dilemma” over whether to apply to join. Most political parties are currently reconsidering the implications of membership.

EU enlargement to the east has also helped to change Norwegian perceptions of Europe. Haakon Kavli, a researcher with MMI, a polling organisation in Oslo, says the biggest shift in opinion towards membership has been in coastal areas. Many fishermen have traditionally been Eurosceptics, but many also sell to eastern Europe, and with those markets soon to become part of the EU they see more reason for Norway to join too.

Together, these trends suggest that Norway will reapply for membership, though not for a few years yet. Next year is too early, and 2005 will mark a century of Norwegian independence from Swedish colonial rule—not an auspicious time to hold a referendum on ceding some sovereignty to the EU. But a vote could come soon after. Terje Osmundsen, a political observer in Oslo, says he expects Norway to be in the EU by 2010.

It's cold outside

If so, Iceland, which already conducts 70% of its trade with the EU, would be unlikely to remain the only outsider for long. EU enthusiasts such as Eirikur Bergmann of Iceland's European Movement think a deal could be struck to preserve control over fish stocks. After all, Sweden and Finland persuaded the EU that their forestry industry near the Arctic circle should be given special treatment, so Iceland might get a similar deal for its fish.

Mr Bergmann, like fellow Europhiles all over the Nordic region, believes that voters will be swayed by the political argument: “Iceland takes 80% of EU legislation but we have no say. We have outsourced part of our legislature to Brussels.” But the most persuasive reason for joining may be the prospect of the single currency: Iceland's krona is volatile and the country is prone to inflation, so interest rates yo-yoed over the years. A survey in February of members of the Federation of Icelandic Industries showed that 59% were in favour of the euro. However, the re-election on May 10th of David Oddsson, prime minister for the past 12 years and an outspoken opponent of EU membership for Iceland, has boosted the anti camp.

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Borderless

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From The Economist print edition

The Oresund bridge has become a symbol of intra-Nordic integration

Untroubled waters

BOARD a train in Malmo, Sweden's third-largest city, and in under half an hour you are whisked above the waves to Denmark's capital, Copenhagen. The Oresund rail-and-car bridge was at last opened three years ago, after a century of talks, nine years of construction and an outlay of Skr 15 billion ($1.9 billion).

The Swedes and the Danes were not always the best of friends—Denmark ruled this part of Sweden until 1658—but these days the two countries are good EU neighbours. They want their respective citizens to be able to cross the shared border more easily, as well as to encourage foreign investors to use the area as a hub of development for the Nordic and Baltic regions. The new bridge puts Copenhagen international airport as close to Malmo as it is to the Danish capital (a mere 15 minutes either way).

The newly named Oresund region of 3.5m people is now developing ties that would not have been possible without the bridge, such as a network of 12 Danish and Swedish universities with 140,000 students and 10,000 researchers, and a “medicon” valley with food, medical and biotech companies that already employ 26,000 people. Anders Olshov of Oresundsinstituttet, a body set up last year to study the effect of the new transport link, says that investment in the project has totalled SKr 100 billion.

Is it money well spent? “There is a sense of disappointment because very high expectations have not materialised,” says Per Ohlsson, a journalist in Malmo. The number of cars using the bridge, at 9,000 a day, is much lower than expected because tolls are steep (SKr500 for a return journey), and cross-border traffic is building up only slowly. Some 2,500 Danes did buy (cheaper) houses in southern Sweden last year, but tax and social-security rules still make it hard to live and work in different countries.

Those teething troubles will no doubt be sorted out, and overall the project is already a success, says Mr Olshov. Culturally, integration is no problem because southern Swedes and Danes already have much in common. Economic benefits are becoming clearer too. Malmo had long been a depressed area, but is now the fastest-expanding city in the country. Small firms are flourishing, and bigger companies such as DaimlerChrysler and Biogen are moving into the area. Many new jobs have been created. If both countries adopt the euro, integration in the region will become even more complete.

Other corners of the Nordics are getting interested in cross-border ties too. Finns are starting to shop in cheaper Estonia as Estonians are finding jobs in Helsinki. And on the border between Sweden and Norway, Swedish retailers have set up shop to allow Norwegians to take advantage of lower Swedish prices. In short, the Nordics are beginning to see each other as an extended home market. But even if there were no internal barriers, that market would add up to only 24m people, so many Nordic firms have to look further afield as well.

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Mix and match

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Is a large flow of migrants a good or a bad thing?

Suits him

ROSENGARD is a suburb of Malmo in Sweden, lined with carefully maintained high-rise buildings. Built to house working-class families a generation ago, it now contains the highest-density population of immigrants anywhere in the Nordic region. For every white face, you are likely to see at least nine brown ones peering down from windows and balconies. Many flats have sprouted satellite dishes so that the newly arrived can watch TV programmes from back home.

According to Mona Sahlin, the minister of integration, “Rosengard is the hardest, most segregated part of the country. In some parts 95% of people don't have a job.” Lars Birve of MKB, a company that manages most of the housing in the area, explains that “in Rosengard you can have a class of 30 children where none speaks Swedish.” Even in Malmo as a whole, over one-third of all residents were born outside Sweden.

A new wave of foreign arrivals in Sweden began 15 years ago. Experts prefer not to call it immigration because most come as asylum-seekers or as part of family reunions, unlike the many job-seeking Finns and others who appeared in the 1960s. But whatever the label, roughly 1m of Sweden's 9m people were born outside the country; and if you add in those with at least one parent born abroad, nearly a quarter of the population are outsiders.

Mrs Sahlin draws a parallel with the number of foreigners, including many Swedes, who washed up on America's shores early in the 20th century: “In 1910 20% of the Swedish population lived in the United States. Now more than 20% of the Swedish population come from another part of the world.” She points out that Sweden's current influx nearly matches the peak of migration to America in 1913, when about 14% of the population there were foreign-born, compared with about 12% in Sweden today. That proportion is higher than in America now, as well as in any other European country.

Why is Sweden attracting so many more foreigners than the other Nordic countries? It is the biggest, most urban and most cosmopolitan of the five, plays an active role on the international stage and has a policy, broadly speaking, of welcoming refugees. In recent years its liberal rules on family reunion have further increased the number of foreign arrivals.

The other Nordic countries have been less hospitable. In Norway the foreign-born proportion of the population is about 7% and in Denmark 6%. Iceland has very few foreigners, other than 2,000-3,000 Poles who regularly work in its fishing industry. And in Finland migration is almost unknown, unless you count an old Swedish minority.

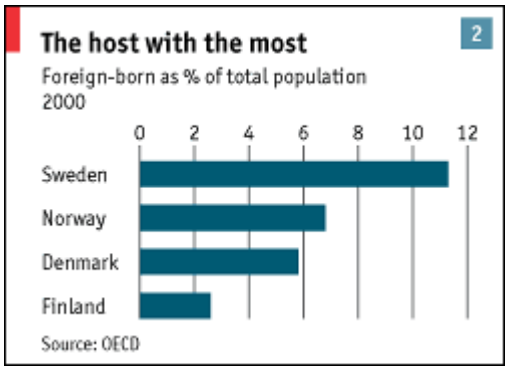
Goodbye to meatballs

But in the three Scandinavian countries, the arrival of large numbers of outsiders with a different culture, religion, history and skin-colour has brought about conspicuous changes. In 1951, that British report on “The Scandinavian States and Finland: a Political and Economic Survey” was still able to state: “There are almost no traces of alien stock in Scandinavia...this racial homogeneity...is reflected in similarities of political outlook and institutions, and of language.” Today Sweden's cities, especially Stockholm and Malmo, bustle with different cultures. In one small square in downtown Malmo your correspondent, sitting in the China Garden restaurant, had a view of the Tehran Supermarket, a shop called Asian Trading and four other ethnic restaurants, the India Tandoori, the Middle East, the Falafel House and the

Krua Thai. Not so long ago the hopeful diner would have been lucky to find a pizza house.

There is more change to come. Theodor Paues at the Confederation of Swedish Enterprise expects one-third of Swedes to be immigrants within a few years, at least by parentage. More migration is likely from the parts of eastern Europe that are about to join the EU. And in Sweden's parliament all the parties except the Social Democrats want a commission to be set up to attract more skilled labour from outside the EU.

Despite tough anti-immigration rules in Denmark and Norway, many foreigners are likely to enter through family reunion, which is hard to block. Mauricio Rojas, a member of parliament for Sweden's Liberal Party and director of Timbro, a think-tank, says immigration is shaking the identity of the Nordics. The most important task now is to manage the integration of so many outsiders.



Back in Malmo's Rosengard in early April, Bejzat Becirov offers a guided tour of his mosque and Islamic school. Mr Becirov arrived from Macedonia in 1962 and is perhaps a model of a newcomer who has bridged gaps between cultures and religions in his adoptive country. “This was the first mosque to be built in Scandinavia, it was built in 1984,” he explains. He took no foreign money from international Islamic organisations for its construction, but accepted donations from churches and synagogues in southern Sweden as well as from the local Muslim population.

It is a Friday, and as classes finish, dozens of small children pour out into the spring sunshine. A few girls wear headscarves. Now the first of 3,000 adults arrive for prayer sessions. “At this mosque 130 languages are spoken, but I tell everyone they must learn Swedish. We have 55,000 members, and 5% of those are ‘original' Swedes,” says Mr Becirov. In the days after September 11th 2001, Christians, Jews and Muslims held meetings in the classrooms of the Islamic centre.

On April 27th Mr Becirov's mosque and school was largely gutted by fire, with arson suspected. Sweden is not especially prone to violence against immigrants, though neo-Nazi thugs occasionally attack foreigners. But nor is it especially successful at integrating outsiders. The next day someone threw a molotov cocktail at the town's synagogue.

The challenge of integration is threefold: to ease clashes of culture between migrants and the native population; to avert a xenophobic backlash in politics; and, most important, to bring foreigners into the workforce.

The first of these will take time. Many white residents, especially those who live away from the larger towns, are simply unused to seeing brown faces. Opinion polls suggest that hostility towards foreigners declines if the locals actually meet them. Mr Rojas, one of 30,000 Chilean-Swedes who arrived three decades ago, says the public has been reluctant to accept *svartskalle* (black skulls) people as true Swedes, which they see as an ethnic identity, although most people agree that outsiders can become Swedish citizens, which is more of a political identity.

Hallo to onion bhajis

Breaking down those barriers can take many forms. In Oslo, Shabana Rehman describes her use of stand-up comedy to provoke discussion between cultures. Sitting in her sister's restaurant, which serves Norwegian-Pakistani fusion food (curried reindeer, spiced monkfish), she explains: “I start my act wearing a burqa and dancing an old Norwegian peasant dance; then I challenge the audience to say what it is to be a true Norwegian.” Many politicians, including those from the anti-immigration Progress Party, make a point of attending her shows. She once posed naked for a newspaper, her body painted in the colours of the Norwegian flag, to the horror of some of the Pakistani community.

Ms Rehman is due to tour rural Norway and several other European countries with her comedy act. She also writes a column for a national newspaper and regularly appears on television. Is it helping? “I think things are changing, there is more intermingling, and more debate among the Pakistanis too. Yes, there's change, but it took a naked Muslim girl to get that change.”

More exposure may help ease culture clashes between individuals, but tackling the political backlash against immigrants is harder. Despite its high rates of migration, Sweden has so far avoided the re-emergence of a populist anti-immigrant party at national level (one spluttered into life a decade ago, but quickly expired). Still, many expect that one will emerge soon, or at least that mainstream parties will propose tougher action to keep migrants out. Mrs Sahlin points to a redneck party, the Swedish Democrats, that did well in the south in recent local elections: “We are not immune. We have between 10-15% of voters who are very strongly against immigration; we expect a big fight in 2006 [the date of the next general election].”

In Norway, a populist and anti-migrant party, the Progress Party, is currently enjoying strong support, though perhaps more because of its charismatic leader, Carl Hagen, than because of its policies. In Denmark, the extremist Danish People's Party has redrawn political lines, increasing its number of MPs to 22 in the 2001 election and now propping up the minority government. Its success is also partly due to a populist leader, Pia Kjaersgaard, a sceptic on the EU and on immigration. Mr Fogh Rasmussen and his Liberals need the support of Ms Kjaersgaard's party in parliament, so the government has had to adopt many of her policies on immigration. Danes are less concerned about political correctness and more inclined to speak their minds than their Swedish neighbours. Many of them openly call themselves racist.

Anti-immigrant? Us?

Mr Fogh Rasmussen denies that Denmark has anti-immigration laws, but he concedes that “in principle we have an immigration stop”, because the government believes that the country has reached the limits of its capacity. In fact, because of family reunion, it is impossible to prevent more migrants coming in, but that has recently been made harder with a range of petty and illiberal rules.

Since 2002 Danes under the age of 25 have not been able to get non-EU citizens into the country automatically by marrying them; entry of foreign spouses is conditional on paying a deposit of DKr51,600 ($8,180), to be used against any claims on the welfare state, and on evidence from the couple that they have a monthly income of at least DKr16,000. They must also prove they have a “close attachment” to Denmark, for example by showing they have lots of Danish relatives. Observers say these rules are specially designed to cut the numbers of Turks, Kurds and Somalis, some of whom come to Denmark through arranged marriages.

Bashy Quraishy, author of a recent book called “Danish Identity Seen Through Brown Eyes”, says the new laws mean foreigners will have to wait as long as 11 years to become Danish citizens, take a language test, prove they have committed no crime in another country and even swear an oath that they will learn about Danish culture and norms.

The most effective way to deal with xenophobic responses and cultural clashes is to make sure migrants quickly become part of the working population. Mr Paues from the Confederation of Swedish Enterprise quotes a 2002 poll which suggested that 67% of Swedes were happy for more immigrants to enter the country if they had jobs waiting for them. But getting foreigners into jobs is difficult. A Swedish study last November showed that the country had 100,000 full-time or part-time job vacancies. Unemployment last year was only 4%, but among the non-European foreign-born population as many as 13.2% were without formal work.

Mrs Sahlin points out that this is a great improvement on 1998, when the rate was over 22%, and insists that migrants are moving into jobs ever more quickly. But trade-union rules make it difficult to hire and fire workers, lower-paid jobs for the less skilled are hard to come by, and a combination of high taxes on low incomes and generous welfare payments reduces the incentive to seek work at all.

The minister is adamant that immigrant workers will not be exploited by being forced into low-skilled jobs, but migrants and the people who work with them on the ground have different worries. Mr Birve in Rosengard complains that people eager to work are too often barred from formal jobs, so take up informal ones instead. He points out that when there were not enough jobs to go round for white Swedish building workers, the government offered tax relief on home refurbishment, causing a boom in the industry. Why not introduce similar incentives to get brown Swedes into formal work too?

There are already plenty of incentives to work in the underground economy. Mr Eklund, the bank economist in Stockholm, suggests that untaxed, unregulated work and smuggling now account for 5-10% of the total economy, though these activities involve natives as well as foreigners. He reckons that migrants would be more easily assimilated if more of them could break into the formal labour market.

This is bound to happen sooner or later. As the Nordic countries' population ages, there will be many more openings for foreigners in medicine, the caring professions and other jobs, especially in the public sector. The question is whether in this way migrants will help to preserve the Nordic countries' treasured welfare model, or whether they will change their host societies so fundamentally that the model itself will come under threat.

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Sharp tongues

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The Nordics' pragmatic choice is English

WHAT do outsiders think of the Nordic people? The list of stereotypes ranges widely: they are good-looking, hard-drinking, heavily taxed and prone to suicide. They are also taciturn, but when they do open their mouths, they speak rather good English. These generalisations may or may not apply to any particular individual, but the point about proficiency in English seems to be true for the vast majority of the region's inhabitants. Most children now learn the language from the age of nine or ten, or even younger. English is quickly becoming the Nordic countries' lingua franca.

In the academic world, nobody can expect to prosper without a good command of *engelsk*. Pia Jarvad, a linguist at the University of Copenhagen, has categorised all the university's theses, articles and books in 1999 by the language they were published in and found that 84% of doctoral theses in the natural sciences were in English, against 14% in Danish.

Danes and Swedes, who can understand each other's language well enough, nevertheless often use English for business meetings. Larger businesses adopted English as their official language long ago. At the Copenhagen headquarters of Danisco, a food company, every single member of staff is fluent in English. Finland's Nokia has used English as its official language since the mid-1980s. Government documents usually have summaries in English at the front. Business cards tend to be printed in English. English-language films and television are hardly ever dubbed, just subtitled. A staggering drunk on the streets of Copenhagen may swear in English; many beggars are fluent in at least two languages.

The use of an outside language does avoid some Nordic complications. For example, Norway's 4.5m people are already having to cope with two national languages. The regular one is rather like Danish, but pronounced differently. The second one, used by about 12% of the population, is called *nynorsk* and was made up in the 19th century by a nationalist, Ivar Asen, who collected various rural dialects that he believed to be “unsullied” by Danish.

Even so, there seems little danger that any of the Nordic languages are about to go out of business. Some of the region's more nationalist parties, such as the Danish People's Party, oppose the spread of English. Most Nordic countries have laws to promote the use of the local tongue in broadcasting and official publications. And all of them are spending more money to teach it to immigrants as a means of integration.

Iceland puts up the most spirited defence of its language, which is closest to the Old Norse once spoken across northern Europe. Its 1,000-year-old sagas were passed down orally, not in written form. “We see our culture in this kind of linguistic monument,” says Audur Hauksdottir, a linguist. Inventing new Icelandic words to replace English ones has become a national sport. For example, the computer has been renamed “tolva”, from two words meaning number (tol) and female soothsayer (volva).

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Krybbe to grav

Jun 12th 2003
From The Economist print edition

Is the much-loved welfare state still affordable?

You'll find it very private in there

A COLD wind blows along Hornsgatan, one of Stockholm's wide, sloping avenues. People hurry into shops or duck into the underground. Buffeted by chilly blasts, one man stands alone on a corner, offering copies of a magazine for the homeless. Is Sweden's welfare state in such decline that working-age (and apparently sober) men have to rely on charity? Probably not. When your correspondent tried to buy a copy, the man was too busy chatting on his hands-free mobile phone to serve him.

Ask a Swede, Dane or Norwegian to tell you what is special about the Nordic countries, and you will soon hear about the Nordic model of social care. Support for high rates of trade union membership, high-quality public services and high taxes seems part of the Nordic identity. The region's people expect free schooling and university education, high-quality health care, generous unemployment and sickness benefits, state-funded maternity and paternity leave, universal pensions and more. The past decade has brought important reforms to public welfare in all the Nordic countries, and further changes are bound to come in the next decade or two, prompted by ageing populations, immigration, wage and tax competition, closer ties with Europe, globalisation and other pressures. But the basic idea of paying high taxes for a generous level of public services enjoys wholehearted support, even among young voters.

The architects of the welfare state were the Social Democrats, traditionally the dominant political force in the Nordic countries. But these days they occupy the prime minister's office only in Sweden. Denmark, Norway and Iceland all have centre-right governments, and in April Finland's Social Democrats became junior partners to the relatively conservative Centre Party. Even so, practically every political party in the region promises to maintain the status quo of high taxes and high welfare. Even in Denmark, Mr Fogh Rasmussen's rightish government pledges only mild cuts. The prime minister explains that “I can't promise a drastic reduction, only a gradual decline in personal income tax from January 2004. Denmark will still have one of the highest taxation rates in the world. But we have a well-functioning public sector.”

Nordic people went from being among the poorest in Europe less than 150 years ago to among the richest in the world a generation ago. By the middle of the 20th century trade, shipping, forestry, iron ore, fish and pigs had generated considerable wealth; since then oil, farmed fish, cheap energy, cars, mobile phones, financial institutions and well-educated workers have added a great deal more.

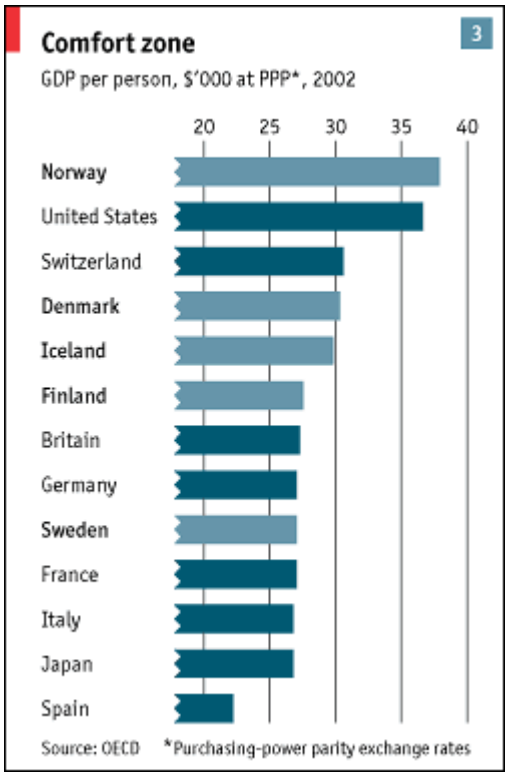
Perhaps just as important, women have long been full participants in the formal, measured economy: they deliver their children to excellent state-funded day centres and go off to do their own jobs. This has meant a bigger formal labour force and a larger tax base.

Rich and even

Are the five economies in good enough shape to sustain a generous welfare model? They are certainly well off. Their 24m people between them generate more income than Spain's 40m, and their national wealth is shared out more evenly than elsewhere. The two luckiest Nordic countries are Iceland and Norway. Iceland does very well out of fish, taps thermal and hydro power for energy-hungry industries and welcomes growing numbers of tourists. A $2 billion hydro-electric system and aluminium smelter, to be built with the help of an Italian company and completed by 2008, should double growth from its

current unusually low rate of 1.5%, says the finance ministry.

Norway, the richest of the Nordic countries, will pump North Sea oil for another 50 years and gas for a century. It is the world's third-largest exporter of oil, and relies on the black stuff for 200,000 jobs. It has been canny about its oil revenues, putting 80% of them into a petroleum fund that is invested overseas, so the benefits should last for many years yet.



But some people are worried that oil-bloated success could smother other parts of the economy. Entrepreneurs such as Thor Kamfjord, boss of a company called PolyDisplay, thinks the oil has made it too hard to find venture capital, hire staff and deal with bureaucracy. “The oil and gas income, in a wider perspective, is a catastrophe. We are getting lazy, high on raw materials, and no good at value generation.” He hopes that his firm, which specialises in flexible display screens, will become Norway's equivalent of Finland's Nokia. But he will manufacture in Spain, Germany or the United States rather than in high-cost Norway.

Others share his concerns. A survey this year on the best places to do business in the next four years, carried out by the Economist Intelligence Unit, a sister company of *The Economist*, ranked Norway only 20th out of 60. Its Nordic fellows did much better: Finland came third, Denmark seventh and Sweden 11th.

After Norway, Denmark is the richest Nordic country, but it relies mainly on trade, services and manufacturing and a range of entrepreneurial medium-sized companies rather than on North Sea oil and gas. Having a densely populated land-mass and two big neighbours, Germany and Sweden, undoubtedly helps.

Finland had to overcome a painful banking crisis after the collapse of the Soviet Union next door, and continues to suffer from high structural unemployment, but the economy is competitive and attractive to outsiders. Esko Aho, a former Finnish prime minister who brought in liberalisation and tax reforms, believes the shock of the Soviet implosion brought unexpected benefits: “We were lucky to have problems in the early 1990s; we had to reform our economy and society.”

With the help of investments in export industries and hi-tech, exports as a share of GDP doubled to 40% in the ten years to 2001. The most obvious symbol of Finland's success is Nokia, now a household name in mobile phones the world over. But that success carries its own risk: the company so dominates the Finnish economy that national economic growth depends rather too heavily on world demand for mobiles.

Meanwhile Sweden, the region's biggest economy, has gradually been slipping behind its Nordic neighbours in terms of income per person. “Sweden has become the poorest in the neighbourhood. Iceland, Norway, Finland and Denmark are richer and on a better trajectory,” says Magnus Henrekson of the Stockholm School of Economics. Ericsson, the country's biggest telecoms-equipment company, is having a rough time. It is shedding 60,000 jobs over three years, and in April reported its eighth consecutive quarterly loss.

The city of Stockholm boomed briefly at the end of the 1990s, mostly because of big investments in technology companies and heavy spending on research and development, but the shine is wearing off here too. Swedes worry about the lack of new big companies. Small service firms do well, but Stefan Folster of the Confederation of Swedish Enterprise points out that every one of Sweden's 50 largest companies was formed before 1970.

In the early 1990s Sweden's public sector became too dominant even for Nordic tastes, with public spending in 1993 reaching 67.5% of GDP and the economy shrinking by 5.2% between 1990 and 1993. Carl Bildt's Conservative government introduced reforms to cut public spending which were carried further by its Social Democrat successor. Since then, says Mr Pagrotsky, the industry minister, “We've had fairly good development for ten years, though we have not been fantastic.”

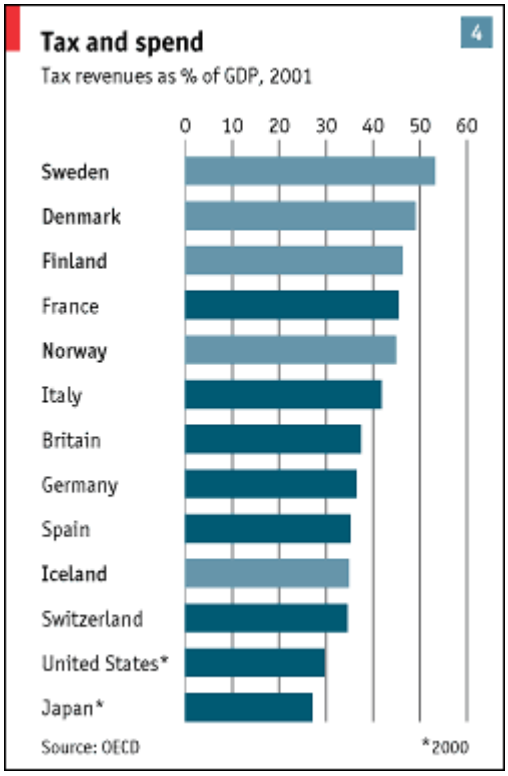
But now he is worried about adverse demographic factors. All the Nordic countries face an acute problem with ageing populations, and Sweden also suffers a higher rate of sick leave and absenteeism than other

European countries. Mr Folster says these problems are so widespread (especially in the public sector and among women) that the proportion of people actually working is now the same as in 1995, when Sweden was in recession. Already the Finns are joking that: “The Swedish welfare state is like a Volvo without tyres: it is a great car, but it doesn't work.”

Whose community?

Not all the Nordic economies may be in great shape, but thanks to natural resources, trade and highly skilled people all five of them can afford to keep their welfare systems going in some form. The question is in what form. Nordic welfare states were born from a shared sense of a “people's community”, known by the Swedish term *folkhemmet*. Much of it grew out of a protestant-Lutheran culture, in which care for the weak is the responsibility of society as a whole. But generous welfare depends on two details of demography and politics: that there are enough people of working age to fund the claims of those in need; and that these working people are willing to pay the necessary taxes.

Every Nordic country will have a top-heavy population until at least the middle of this century as large post-war generations begin to retire. By 2050, says the UN, pensioners will equal 45% of the working-age population in Norway, 49% in Finland and 54% in Sweden. Across the region the number of workers per pensioner is set to halve by mid-century. Various measures are now being introduced to encourage older people to keep working. An official Finnish study published in April, the Sailas report, proposed measures to increase employment by moving students more quickly from school or university into jobs, and by raising the age at which people actually retire.



Privately funded pensions are being introduced in all the Nordic countries to reduce the huge liabilities being piled up by public pensions. On current trends, by 2050 public pensions are expected to gobble up 7% of GDP in Denmark, 10% in Sweden and 18% in Norway. A few economists are even suggesting that universal state pensions be phased out and replaced by means-tested ones. And many more advocate creating incentives for older people to work until later in life. Torben Tranaes, a professor of welfare economics in Copenhagen, calls this “the most effective cure to get a bigger workforce.” Denmark's government has announced a scheme to let workers postpone drawing their pensions in return for improved benefits later, and others in the region are likely to follow suit.

Do you sincerely want to pay tax?

But will those in work really be willing to keep paying the taxes needed to keep the system going? Polls and election results seem to show that the high-welfare, high-tax model still commands popular support, but there is also some evidence to the contrary. Mr Eklund, the economist at SEB, says Swedes increasingly move money offshore to avoid paying tax. He puts the total being kept overseas at a hefty SKr 500 billion ($65 billion). And many Swedes are prepared to employ black-market labour, for cash, to look after their children and old people and in construction and farming.

One way of keeping the welfare state going is to allow more foreigners, especially young ones, to come in to take jobs (and pay taxes). But that may create its own problems. Some economists and sociologists say a more ethnically mixed society may make the idea of the *folkhemmet* more difficult to sustain and lessen the general willingness to pay taxes.

Mauricio Rojas argues that the welfare state and immigration are very closely linked. “The welfare state presupposes a strong community. When you take tax you must redistribute to a community near you. The difficult problem is that immigration is resented by some Swedes who say, ‘they are taking our money'. For a welfare state to exist, you need a close community.” As monoethnic Sweden becomes a nation of nations, he fears that support for the welfare state might flag.

Mr Tranaes in Copenhagen points to an unpublished paper by John Roemer of Yale which suggests that ethnically homogenous societies are more willing to pay taxes. “In homogenous Denmark, people trust that the government will use revenues in the right way,” says Mr Tranaes. “But a more multi-ethnic society poses a threat to this attitude.” One characteristic of populist parties in Norway and Denmark is a combination of anti-immigrant attitudes with strong support for the welfare state.

When the Nordic countries first established their welfare models, they were responding not only to domestic factors but also to international pressures. Jon Bingen, a historian in Oslo, reckons that one strong motive was to avoid the threat of revolution and violence as experienced in nearby Russia. Inspired by German social democrats, the countries set up trade unions and established a strong welfare net to pacify the workers and stave off revolt.

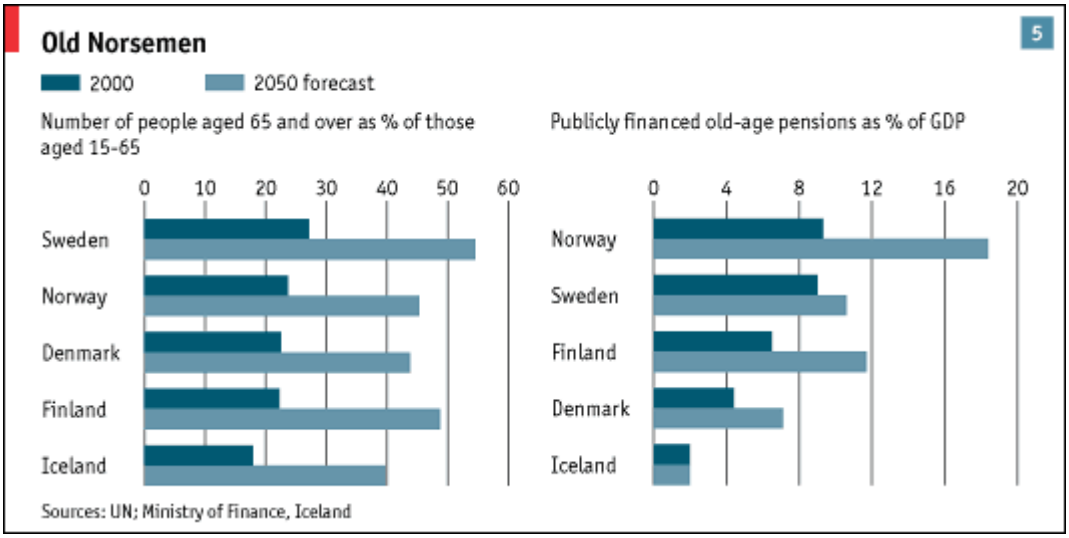
Today, international pressures are working in the opposite direction. All the Nordics are worried about competition from less heavily taxed countries, as well as EU legislation and the ability of capital to move round the globe at will. Tax competition is seen as a particular peril. So far there is no proof of a widespread brain-drain of highly skilled workers to low-tax countries, but there is some anecdotal evidence. Many Nordic youngsters go to work (although mostly temporarily) in London, Brussels, New York and other foreign cities. High taxation at home may be only one of many motives, but there is little traffic in the opposite direction.

In the corporate field, tax competition is eroding the Nordic region's revenue base. Finland has a relatively low corporate tax rate, at 29%, but in nearby Estonia, which will shortly become a member of the EU, the rate is zero. Some Nordic companies, such as Sweden's IKEA, a furniture company, and Tetra Pak, which makes packaging, have moved their headquarters abroad. “People and money are being driven out of the country, you will find it all in London or Monaco,” complains one senior Swedish businessman. Sweden's government now offers special tax exemptions for the richest individuals, and Finland taxes foreigners less heavily for a while. That keeps people in the country, but it undermines the principle of high taxation for all.

Sales tax across the region is mostly around 25%, but Nordic shoppers can buy goods cheaply online from other parts of Europe, or travel to nearby Baltic countries for bargains. Alcohol and cigarette taxes, long used to gain revenue and discourage undesirable behaviour, are being undermined by EU legislation allowing imports of large quantities of either for personal use. Jens Spendrup of Spendrups brewery complains that already one in three bottles of beer in Sweden has been bought (and taxed) overseas. Nordic leaders are unsure how to react. Sweden is slowly lowering its taxes on booze, but the Finns are pushing for a pan-EU effort to raise the price of alcohol in other member countries instead. Mr Eklund sums it up: “The tax base is being eroded by international competition.”

Freedom of choice

Given scarce resources, the welfare state must either shrink, for example by supplementing public with private pensions, or become more efficient. The Swedes, in particular, have been experimenting for a decade in an effort to make the welfare system less cumbersome, and to offer middle-class voters more choice. Thomas Ostros, Sweden's bright young education minister, says that freedom of choice has become more of a basic ingredient of the welfare state.



About 6% of younger Swedish students, and 8% of older ones, now go to independent schools that are privately run and allowed to select students according to criteria they set themselves, for example by academic ability. That is a radical change in Sweden, where equality of education long meant that stronger students would be discouraged from moving too far ahead as weaker students were encouraged to catch up. All the schools continue to be state-funded and free to users and must meet national education standards, but Sweden's Social Democrats are, in effect, trying out a school-voucher system. “You can start an independent school if you meet the right conditions. You get the same money as a public school would. It is not quite the same as a voucher system because the schools get more money for students who need extra support, but there is freedom of choice, with resources following the choice. However, the most important thing is equality,” says Mr Ostros.

In the health system some hospitals (including Stockholm's largest) and clinics are now privately managed, though state-funded, and users are free to choose which clinic to attend. More private clinics are opening across the Nordic region. The 20,000 flats in Malmo where newly arrived migrants and asylum-seekers are put up are also managed by a private company, MKB. Mr Rojas says the welfare state is undergoing significant reform as public-private partnerships are tried out: “Sweden had the most extended welfare state on earth, it was the role model for Nordic countries. Now this has totally changed. My children go to schools managed by commercial companies; in Stockholm almost all clinics are private enterprises, but within the public sector. The new Swedish model is a combination of solidarity and freedom.”

But some fear that the changes now being introduced are the thin end of the wedge, and that once the principle of change has been accepted, the old system based on need might eventually be replaced by one based on the ability to pay. Jan Larsson in the Swedish prime minister's office says there will be no backtracking on the changes that have been put in hand, but he also insists that the welfare state will not be dismantled: “Liberalisation has begun. We honestly believe in the need for alternative schools and clinics. But we don't believe in opening everything up for privatisation.”

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From Vikings to peacemongers

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From The Economist print edition

The Nordics work hard at being the world's conscience

SOME students of foreign policy like to categorise countries by the personality of their people. By that measure, Norsemen of a millennium ago were greedy psychopaths. Fierce warriors, pillagers and traders, the Vikings sacked Paris in 861, conquered much of England and northern France, settled Iceland and Greenland, discovered America and even helped to raid Baghdad.

That bloody projection of military might overseas makes today's Nordic do-gooding look feeble. One observer now describes the Nordic personality as that of the world's group therapist. For the Nordic countries themselves, being seen as peace-loving nations intent on battling only poverty is an integral part of their self-image. Gunilla Herolf, of Sweden's Institute of International Affairs, says that “happy activism is part of our identity”.

Naturally there are differences between the foreign-policy objectives of the five Nordic countries. Mr Fogh Rasmussen, Denmark's prime minister, says there is “a tradition of following different paths for foreign and security policies.” During the cold war, with the Soviet Union breathing down Finland's neck, the countries constructed a mix of allegiances and neutrality known as the Nordic balance. Denmark, Norway and Iceland all joined NATO, whereas Sweden and Finland professed neutrality and handled their Soviet neighbour with kid gloves. These days the EU is increasingly seen as a vehicle for foreign policy that might come to rival NATO, but for now Norway and Iceland remain outside the European club.

The American and British invasion of Iraq provoked sharply different responses within the Nordic region. Some European diplomats in Copenhagen derided Denmark as the “Voice of America” after it sent a ship and a submarine to support its NATO allies. But Mr Fogh Rasmussen is unrepentant: “As a small European country we would rather rely on a superpower's security guarantees than on a European one based on a French, German and British security balance”. Iceland, which hosts an American military base, quietly joined Denmark in its approval of the American-led action. But the other NATO member among the Nordics, Norway, cautiously expressed regret, along with non-members Sweden and Finland.

Mr Bingen, the Norwegian historian, argues that the interests of the five countries have always been very different, and remain so: Finland still keeps a beady eye on Russia, but is also looking to develop ties with the new eastern European EU states; Norway cares only about the sea (“oil, gas and fish”); and Iceland subordinates itself to America.

But the differences should not be exaggerated. None of the Nordic countries is particularly pacifist. Sweden's defence spending is among the highest in western Europe. Norway sent fighter planes to Afghanistan and supported NATO in Kosovo in 1999. And Finland has had an almost fanatical love for its armed forces since they held off Russian invaders in the second world war. “The army is the most popular institution in Finland,” says Mr Lipponen. There is widespread support for conscription, and one poll shows that 80% of Finns would fight for their country “even if the prospects of survival are dim”.

All five countries attach great importance to support for the United Nations, generous spending on foreign aid, peacekeeping and peace-brokering. So might some sort of common Nordic foreign policy eventually emerge? The three EU members among them are beginning to give this some thought. They think that within the enlarged EU, a northern European voice will be heard better if the Nordics (and perhaps Balts) spoke together. Already Nordic leaders meet to formulate common positions on subjects of interest to them ahead of EU gatherings. Mr Fogh Rasmussen says that “in the future we will see stronger regional co-ordination,” though he sees this as taking the form of “active bilateralism”—choosing partners for particular issues. Other politicians and observers agree that closer co-operation is bound to emerge but will stop well short of the formation of a Nordic block. Lykke Friis, the Danish academic, thinks that “the essence of the game now is how Nordic co-operation can be used as a platform within the European integration process.”

EU-enthusiasts in Norway and Iceland argue that membership of the Union would give the Nordics a stronger voice, for example in dealing with Russia, channelling aid to the Baltic countries and on environmental issues. Only Finland might be hard to persuade of the merits of this strategy: so far it has relied on clubbing together with other small countries (known as “the seven dwarves”) in the Union, and leaving the European Commission to act as a referee.

On non-EU issues, the Nordics have long been supporters of peacekeeping. Norway played a part in the first such operation under UN auspices in 1947 and has since deployed some 55,000 troops on such duties; Finland sent blue berets to the Middle East after the Suez crisis in 1956; and Sweden has made available about 90,000 soldiers to UN armies since the country took part in the Korean war. All these countries are developing quick-response teams of peacekeepers to be deployed in trouble-spots. A joint Nordic battalion worked in the Balkans to prevent war in Macedonia. Ironically, Danish soldiers had to withdraw from the operation in Macedonia this year when command passed from NATO to the EU because of Denmark's opt-out on military affairs, whereas Norway, a non-member of the EU, has been able to continue.

A moral superpower?

The five Nordic countries have a good deal in common. In essence, they are all democratic, protestant, pro-UN, anglophile and pragmatic; they also have an Atlanticist streak, partly because of huge emigration a century ago (every Swede or Norwegian has an uncle in America). A Norwegian journalist, Peter Norman Waage, puts it bluntly: “Traditionally our foreign policy bows to a bottle of Coke.” Even Sweden has been retreating from its non-alignment by forming a partnership with NATO and joining the EU. According to one senior Swedish observer, membership of the EU has made a big difference to the country's neutrality and independence.

What the Nordic countries also share is their self-image. They may not be a “moral superpower”, in the phrase of one Swedish minister, but they do all want to make the world a better place, with foreign aid and in other ways. An eminent Swede dubs it an “Oxfam sentiment”. Norway's Mr Bingen, less charitably, says this is a naive policy, “as if we were a peace-research institute or a development-aid agency” rather than modern nation-states.

Sweden set the pace during the cold war by supporting African liberation movements such as the African National Congress and then giving huge dollops of aid to favoured countries such as Tanzania. Its reward was support from the UN and some senior posts in the international bureaucracy. Denmark's cost-cutting government may have reduced foreign aid, but it remains one of the most generous donors in the world.

More recently Norway has held the torch as a “moral and humanitarian entrepreneur”, in the gushing words of one journalist. It specialises in trying to broker peace deals between warring factions. The Oslo peace accord in 1993 was a laudable effort to resolve the Israel-Palestine tangle; a 1996 peace accord in Guatemala was nudged along with Norwegian help; a Norwegian negotiator has been trying to get Colombia's government and various rebels to talk; in Sri Lanka a tentative peace deal was concluded last August with help from Oslo. In Sudan Norwegian aid groups have played an active, though not necessarily useful, role. In Zimbabwe's stolen election in 2002, Norwegian monitors usefully remained in place after EU staff were expelled.

Norway owes its relative success to its patience, the general respect it enjoys as an honest broker, and to its oil wealth. It still has a faint collective memory of what it is like to be downtrodden: Sweden's rule over it ended less than a century ago. Though Norway has no power to enforce peace agreements such as the Oslo accord, it enables others to sit down and talk. This has won it kudos, employment for lots of young Norwegians in international organisations, and possibly a bit more clout in the UN and elsewhere than it could otherwise have expected. Norwegian citizens, naive or not, seem happy with that.

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Identity changes

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From The Economist print edition

Older, more multicoloured and more outward-looking, but still the same deep down

Just a small one, then

THIS survey has argued that the identity of Nordic people is changing. Of course nowhere stands still, but for the Nordics the present shift is the most significant in decades. The transfer of sovereignty that comes with membership of the EU is a direct challenge to national identity, and may bring changes in foreign policy in its wake. Surging immigration has made the Nordic people less homogeneous, causing them to wonder who they are becoming. Even the defining characteristic of modern Nordic countries, the welfare state, is undergoing fundamental changes. And all the while, businesses and people move back and forth within the region and in and out of it. Even the language is gradually changing.

At the day-to-day level, technology too is making a big difference to people's lives. Finns, Swedes, Danes, Icelanders and Norwegians are among the most IT-savvy people anywhere. They use the internet, mobile phones and broadband with the same gusto as the most technology-obsessed Asians. Toddlers play computer games almost before they can walk. In Finland you can buy a ticket for the metro, turn on your sauna from miles away, see how much tax your neighbour pays, order an application form for a university course, check in for a flight, pay to have your car washed and find out if there are any single men or women in your ski-lodge, all by using text messages on your mobile phone. Some Finns expect mobile phones soon to replace credit cards as the most common form of making electronic payments.

Technology may even be making Nordic people more outgoing. Finns are renowned for their dislike of conversation. An old Finnish joke has two men sitting in a sauna, drinking beer. “Cheers!” says one, raising his glass. An hour and a few refills later, he raises his glass again and repeats: “Cheers!” Another hour on, and he breaks the silence yet again: “Cheers!” The second man is speechless with anger, but eventually brings himself to reply: “Are we here to drink or to talk?”

However, mobile phones seem to have helped to break the taciturn habits of the Finns and their Nordic neighbours. As they retreat to isolated woodland and lakeside cottages this month, they will continue to communicate with friends and family on their handsets.

Social drinking

That other stereotypical Nordic activity, binge-drinking, may also be becoming a thing of the past. Ingeborg Rossow, a researcher with Norway's institute for substance abuse, SIRUS, says that Norwegians and Swedes have traditionally been causing more injuries per litre of alcohol drunk than other Europeans, but now drinking patterns seem to be shifting away from violent binges. More money helps, and so does increased travel and the resulting contact with different ways of life. Ten years ago Helsinki had only 40 outdoor cafés; today it has 600. One Finn who works in Brussels gently suggests that his countrymen are becoming more extrovert: “We used to talk and look down at our shoes. Now, when we talk, we look at the other person's shoes,”

The Swedes especially, with their heavy inflow of migrants, are having to learn to live with big social changes. In time most Swedes are likely to accept that the *folkhemmet* can include people born in other countries, even if they have a different religious and cultural background (although there is also a fair chance that an anti-immigrant party akin to Denmark's may emerge). Sweden will have to make up its mind whether to reduce the inflow of asylum-seekers, now around 40,000 a year, or allow more migrants in to work legally. It may decide to do a bit of both.

And as more foreigners come in and settle in Sweden, they may in turn help to change their host country's values. Even neighbouring Danes say they cannot understand why the Swedes have for so long put up with a nanny state that tries to run every aspect of their lives. As the Swedish population becomes more heterogeneous, it may demand more choice within the welfare state and become more reluctant to pay exorbitant taxes.

A change of philosophy

The new catchphrase now being bandied about in Sweden's corridors of power is “freedom with solidarity”. Out goes the old one-size-fits-all approach; in come more private-public partnerships and more flexibility so individuals can tailor pensions, insurance, schooling and health care to their own preferences. The same is happening in the other Nordic countries.

A closer relationship with the EU has become more likely, even though not everybody looks forward to it. Some Norwegians say it will soon be time to “hold our nose and join”. Sweden's vote in September on adopting the single currency is likely to be close. The prime minister is in favour and has told sceptics within his government to shut up, and although the economic arguments are finely balanced, the Swedish people tend to accept the advice of their leaders on such matters.

If the Swedes vote yes, Denmark's Mr Fogh Rasmussen may be encouraged to risk calling a “big-bang” referendum on his country's various EU opt-outs, including that from the euro, in the next two or three years. In Norway, the centenary of independence from Sweden in 1905 makes that an inauspicious date for deciding on EU membership, but if polls show continued support for joining, a referendum could come soon after. If Norway joins, Iceland too will reconsider membership, in the hope of extracting a deal on fishing.

This mixed bag of identities—national, ethnic, pan-European, Atlanticist, multilingual—leaves room for a resurgent Nordic identity as well. Despite the clear differences between the five countries, there are good reasons for the Nordic countries to want to co-operate more closely. Within an enlarged EU, there will be a greater need to line up allies in Brussels or Strasbourg, for which the other Nordic countries will offer the closest match of economic, social and political interests. In foreign policy, especially of the peacekeeping and humanitarian sort, the Nordic countries can hope to achieve a lot more together than separately, so they will seek more co-operation along the lines of the Nordic peacekeeping battalion in the Balkans, particularly if Denmark scraps its EU opt-out on military affairs.

As the Nordic countries' identities change, will they be able to hold on to their old tolerant, rich and happy dream? The chances are that on midsummer night in 2050, the dancers round the maypoles will be older, greyer and slower, and some of the people sailing the boats in the fjords will be brown even if the sun doesn't shine. The Nordic countries will all use the euro and subscribe in full to the EU's various social, economic and foreign-policy rules. They will still be pretty rich, and their welfare services will remain more generous and universal than elsewhere. And without a doubt, their people will still be deeply in love with the mountains and the forests. Some things never change.

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Ford's troubles

One hell of a birthday, Bill

Jun 12th 2003 | DETROIT AND COLOGNE
From The Economist print edition

AP

Ford celebrates its 100th anniversary, fighting for survival

Get article background

IN DEARBORN, the Detroit suburb that is its home, the Ford Motor Company this weekend will host parties for several hundred thousand guests to celebrate the birth of the company on June 16th 1903. Ford's centennial bash will range from Model T rides to rock concerts. The company's founder, Henry Ford, would have been impressed to see his great-grandson, William Clay Ford, today's chairman and chief executive, help to install a pair of giant blue ovals on Ford's world headquarters.

The return of the company's traditional logo is a highly symbolic step. It had been abandoned as a corporate symbol (but not as a car badge) three years ago by Jacques Nasser, the then chief executive, who had embarked on a crusade to transform Ford into a global consumer-services company. Its return is part of Mr Ford's “back-to-basics” campaign, which is reversing the changes that Mr Nasser made during his brief tenure. The biggest of these was to turn a profit of $7.2 billion in 1999 into a loss of $5.4 billion in 2001, after which Mr Nasser was sacked.

Putting Ford back on the road to financial health will be a gigantic task, despite its bounceback into profit in the first quarter of the year. For a company that once seemed more resilient, more international in outlook and readier to embrace new manufacturing techniques than its Detroit neighbours, General Motors (GM) and Chrysler, Ford is caught in a tight spot. The Ford who now leads the firm is fighting for its survival.

Barely three years ago, Ford seemed likely to overtake GM to become the world's biggest carmaker, a title Ford lost in the 1930s. It had racked up total profits of $56 billion from 1993 onwards. But it spent too much buying Britain's Land Rover and Sweden's Volvo, as well as the Kwik-Fit tyre-repair chain and other businesses. On Mr Nasser's watch, the company also had to stump up for the huge cost of replacing dangerous Firestone tyres fitted to Ford Explorers. Important product launches were botched and quality control was neglected, to the point that warranty claims soared almost out of control.

Since Mr Nasser left, Ford has sold many of its acquisitions, but the core business of making cars is far from being fixed. Despite spending a fortune on rebates and other incentives to lure buyers, Ford's market share has fallen in America. In Europe it has shrunk from 12% to barely 8%.

Meanwhile, Ford's underfunded pension liabilities and retirees' health-care obligations have become a financial nightmare. Some on Wall Street, including Saul Rubin, an analyst at UBS, have given warning that Ford might not last the decade, never mind another century.

The last time Ford was heavily in loss was when the market slumped in the early 1990s. This time it coincides with four years of record vehicle sales in America. Even though the market weakened this spring, the number of vehicles sold in America could still pass 16m for 2003. Yet Detroit is in the dumps. Alarm bells rang last week when DaimlerChrysler issued a profit warning for its Chrysler arm, which expects to lose $1.2 billion this quarter, dashing hopes of a profit of $2 billion for the year. Analysts are standing by for gloomy news from Ford and GM—even though Ford, when it last reported, stuck to its forecast of a small profit this year.

Not another new car

This is no market for weaklings. Overcapacity is more than 20% in America, and growing. Hundreds of thousands of cars are piling up unsold, even as Japanese manufacturers build more efficient new plants. Last month, Nissan opened a factory in Mississippi able to make 400,000 vehicles a year—including the sort of pick-up trucks and sport utility vehicles (SUVs) from which Ford, GM and Chrysler have made most of their recent profits. Germany's big carmakers are also driving hard into the SUV market. Every other car sold in America is now a pick-up, SUV or similar. Toyota and Honda are expanding their North American production as they steal market share from Detroit (see table). Toyota is on the way to replacing Chrysler as one of America's big three carmakers.

The capacity glut is forcing manufacturers to fight for every sale. This is compounded by a weak American economy and the fact that, after a decade of strong sales, America is awash with more cars than ever before. The solution might seem simple: close plants. But to shut down the five plants first targeted by Ford in its January 2002 recovery plan, the company had to win approval from the Canadian Auto Workers Union and still has to clinch a deal with America's United Auto Workers (UAW) union. So, 18 months after declaring much manufacturing capacity surplus to requirements, Ford is still saddled with it. This delay worries analysts, who contrast it with the quick recovery that Carlos Ghosn was able to effect when he took the reins at beleaguered Nissan.

Shifting down

US car and light truck market share, %

	1996	2003*
Detroit's big 3†	72.5	63.9
Japan's big 3‡	17.9	22.6

*Forecast †General Motors, Ford, DaimlerChrysler
Source: *Automotive News* ‡Toyota, Honda, Nissan

To prevent cars piling up on sales forecourts, Ford has had to increase discounts and other sales incentives by over half this spring. The result is that it costs Ford $3,208 to sell every passenger car. Even its newest and most popular vehicles are rolling out with “cash on the hood”. That spells big trouble for Ford, as it has just made what Phil Martens, the company's development director, calls “the most important product launch for us in 20 years”. This is the completely redesigned F-150 pick-up, the mainstay of Ford profits and the best-selling vehicle in America (900,000 or so in a good year). The company hopes to sell over 1m in 2004. To do it, Ford has produced five versions of the new F-150, aimed at different market niches.

Sticker shrink

Jim Padilla, who runs Ford's North American operations, concedes that the company has underestimated the pressures on pricing. Since the mid-1990s, sticker prices have fallen by a real 1% a year. Yet Ford has spent the equivalent of about $1,800 in extra costs to produce each new pick-up. Frantic cost-cutting efforts has trimmed that to an average of $711 as the first new F-150 rolled off the production line this week. But that is still a painful dent in Ford's most lucrative product. Ford finds itself doing the equivalent of trying to drive up a down escalator: its new vehicles tend to be fancier and so more expensive, but car buyers expect and get lower prices.

Ford is hoping to fight back using techniques that it has learnt from the Japanese and already applied in Europe. Sir Nick Scheele and David Thursfield, who slashed surplus capacity at Ford Europe, have been drafted in from the European headquarters in Cologne to take over day-to-day operations and purchasing. But there are repeated rumours of friction between the tough Mr Thursfield and the equally forceful Mr Padilla.

EPA

They don't make ‘em like they used to

After closing surplus plants, such as the assembly line at Dagenham in Britain, Ford Europe is refitting its remaining four big European factories. Only the walls and roof of its giant Cologne plant remain the same. Inside is now a squeaky-clean, world-class factory, as productive as the best Japanese plants in Europe, and employing factory managers who learned their job at Toyota. Like Japanese car factories, the Ford Europe plants can make any model, so production of particular vehicles can be raised or lowered according to which model is selling the fastest. But what was done quickly in Europe is yet to materialise in America, unless the powerful UAW agrees to changes.

Another Japanese trick that Ford has learnt is to make many different models using the same “platform”—the basic chassis and other under-the-skin parts. Ford's new medium-sized saloon to replace its ageing Taurus model will share the same platform with a new Mazda, launched last year by Ford's Japanese partner. Eventually, Ford plans to produce ten different vehicles from the common platform. On paper, at least, it could save billions from lower product-development costs and rewards from economies of scale.

One of the biggest weaknesses Ford has faced has been in product development, which had been unnaturally divided into autonomous departments, each focusing on a different segment of the market. The result, laments Jim Hall, a Detroit car industry consultant, was that Ford kept reinventing the wheel, failing to share technical advances, and missing out on economies of scale. Some new models had to be curtailed simply because their costs spiralled too high. That, in turn, creates another problem: finding enough new cars every year to grab buyers' attention. Ford's dramatic slide in the European market, for instance, came as the average age of its models rose to more than five years; it is now under half that, according to Martin Leach, chief operating officer of Ford Europe.

Ford's problems affect more than the cars with a blue oval badge. Under Mr Nasser, the company shifted a lot of attention to its European luxury brands, such as Land Rover, Aston Martin, Jaguar and Volvo. This was to the detriment of its Mercury marque, which in the months before Mr Nasser was ousted had been the subject of an internal study to see how it could be axed. Now Ford is trying to come up with new products to provide a clearer image for the brand. Grand designs for Ford's Lincoln brand, also dreamed up under Mr Nasser, have been scrapped. Sir Nick dismisses them as “not supportable”. So Lincoln is struggling to find a workable alternative that focuses solely on the American market, rather than the global launch planned by the previous regime.

Despite the gloom, some analysts believe the company's situation is improving. So far this year, Ford has outperformed GM. Vehicle quality is improving, cutting warranty costs. But the F-150 launch will be the big test of whether Ford has really got on top of its repeated start-up problems. By 2005, the carmaker promises to cut $9 billion from its costs; this week the company said it was making faster-than-expected progress at the first three plants converted to flexible manufacturing.

A long-standing industry maxim holds that you cannot cost-cut your way to prosperity—though it certainly would help. The real measure of success is whether Ford can make hit models. That will, in part, be determined by the reception given to the 65 new cars, SUVs and other vehicles that Ford plans to roll out over the next five years in America—along with an almost equal number from its luxury European brands. Even though Ford is more than halfway through a five-year plan to launch 45 new cars in Europe, it has not seen much improvement in sales.

The European car market is glutted, and likely to shrink by 10% this year. According to Gary Lapidus, an

analyst at Goldman Sachs, Ford was still losing $621 per vehicle in Europe in the first quarter of this year. So the medicine developed in Europe, and on which so much hope in America is pinned, has still to show that it really works.

As if Ford doesn't have enough problems, it is paying a penalty for efficiency gains made over the past two decades. The firm is saddled with more than one retired person for each active worker. The situation is similar at Chrysler, and worse at GM, which has more than two pensioners per employee. Analysts recall GM's brush with bankruptcy in 1992, when a further downgrading of its bonds would have caused unbearable financing costs and forced it to seek protection from creditors. Ford's bonds plunged last autumn; they have recovered but are hovering just above junk-bond status.

Some in the industry cannot envisage the company that epitomises the automobile going bust. “Ford is too disciplined a company to go down,” says the chief executive of a rival carmaker. But nobody thought such household names as Pan Am or ITT could vanish. Ford could yet hurtle over the edge.

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Investing in Angola

Into Africa

Jun 12th 2003 | LUANDA
From The Economist print edition

After a long war, bold entrepreneurs start to arrive

Get article background

WHY has British Airways started a weekly flight from London to Luanda? Angolans are not fleeing, but others are flocking in. Since 27 years of war ended last year, more and more foreign investors are eyeing up the former Portuguese colony. Angola makes about $3 billion a year from oil; some of the money once spent on fighting should make its way into post-war reconstruction. The government has ambitious plans to build roads, bridges, shops, hotels and more.

Offshore oil companies have long done business in the country, but war and massive corruption have made most others wary. With peace, that is starting to change. South African entrepreneurs are leading the pack. Tokyo Sexwale, a South African tycoon, recently announced that he will start mining diamonds at two sites. A development of 2,400 homes is being built in Luanda by Group Five, a South African construction company. Shoprite, a South African retail chain, is said to want to open stores in Luanda.

“We are very aggressively pursuing this market. We know the environment,” says a South African diplomat. Other South African firms taking an interest include Eskom, which is looking at the hydro-electric potential of the country's many rivers. De Beers, the diamond company, has spruced up its Luanda offices. MTN and Vodacom, two mobile-phone operators, reckon Luanda's elite would pay handsomely for a reliable telephone system.

Interest also comes across the Atlantic, from Portuguese-speaking Brazil. A Brazilian transport firm, Macom, now runs Luanda's buses and its only taxi service, and a Brazilian public-relations company produces Angola's only national daily newspaper. Brazil's president will visit later this year to drum up business. A British company, Crown Agents, manages the customs service. French banks are present for oil business and Portuguese builders are vying for housing and other projects. An American construction company, Acrow, is angling for contracts beyond the capital.

Will it be worth the risk? Angola is not an easy place to do business. The government is so corrupt and secretive it has failed to secure a loan from the International Monetary Fund. Nor are donors ready to organise a finance-for-development conference for post-war construction until there is more transparency: United Nations' officials reckon at least $1.5 billion is needed. This discourages banks from lending to non-oil projects and raises the cost of doing business.

The high cost of borrowing has also hit the government. Preferring secretive loans from banks, it is borrowing privately at high rates of interest against future oil revenues. Many diplomats, traders and others in Luanda believe the Angolan government is broke. A South African air-conditioner salesman, Marius Calitz, says he will not accept any official contract because “they have no money”. Instead he is raking in as many private deals as he can. “My timeline is five years. Get in, make some quick money, get out. In five years, everybody and his dog will be here.”

If oil revenues boom and a deal is clinched with the IMF, things could move quickly.“We want the green light from the IMF,” says a government spokesman. But corruption is a way of life. A foreign businessman admits that “bribes are essential.” Another says that all activities are supposed to be joint-ventures with local partners, who slice off a big cut.

For some that is the price of getting a toe in a new market. An election is due before 2005. The government needs to see results from rebuilding to drum up popular support, especially beyond the capital. There are plans to renovate (and clear landmines from) an extensive railway network that

reaches Congo and Zambia. The government talks of a national network of airports, an oil refinery on the coast and more. If any of this becomes a reality, BA may need more flights.

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Japanese innovation

Redesigned

Jun 12th 2003 | TOKYO
From The Economist print edition

Japan's best engineers are having to learn about business

IN A country that worships technology, Japan's engineers are greatly revered. Their designs, from cars to endoscopes and mobile phones, are sold across the world. But Japan is having to send its top technicians back to school. Electronics giants such as Hitachi, Matsushita, Fujitsu and NEC, are enrolling their chief engineers and R&D heads on “management of technology” courses (MOTs, or as they are sometimes known, MBA courses for engineers) to brush up their business skills.

Only a few years ago, such courses were almost unheard of in Japan. Now universities, think-tanks and companies are scrambling to set up technology-management schools. Already this year the Ministry of Economics, Trade and Industry has signed up 46 companies and institutions to develop teaching courses. Each project gets a ¥10m ($84,000) grant. As evidence of the government's desire to foster a more entrepreneurial spirit in research labs, the ministry's budget for the entire programme, initially ¥120m, was recently boosted to ¥2.9 billion.

Behind the rush to get an MOT is a realisation that Japan is losing its competitive edge. The country's technological prowess is still ranked highly, but its ability to manage those skills has diminished. What Japanese scientists and project managers most lack is an understanding that time costs money and that delays can be expensive, says Takeshi Kadota of Mitsubishi Corporation, Japan's biggest trading company. He has helped to set up a technology-management course at the Tokyo Institute of Technology. Many bosses have not managed their research staff and they rarely set clear strategic goals, adds Kenji Furuta, president of Fusion & Innovation, a consultancy.

That is changing, as Japan's long-running recession continues to bite. Companies are slashing R&D budgets and searching for efficient project managers. Such people require both technical and managerial skills to oversee programmes that increasingly cross divisions within a company. At the moment, admits Hiroshi Kikuchi, the head of corporate R&D and production at Matsushita, most engineers are simply too specialised in their specific fields to manage projects this way.

Yet they will have to. Mr Kikuchi believes that, if Japanese manufacturers are to compete against nimbler low-cost rivals in China, the development of future products will involve a mix of different technologies and services. Canon and Ricoh, two successful photocopier companies, already combine mechanics, toner technology and servicing skills.

As Japan's student population shrinks in an ageing society, universities are delighted to find ways to attract older, richer students. Some companies, such as Osaka Gas, the second-largest gas company, are setting up their own MOT schools. The company wants to groom good engineers who can develop new sources of profits. Osaka Gas has already grabbed a big share of the world market for parts used in rechargeable lithium batteries, which are used in mobile phones. Along the way, it discovered that customers, especially foreign ones, have strict cost requirements it needs to match.

It is unclear how successful these courses will be. Ichiro Murata, a director at the Academy of Management Development, which lists many of Japan's corporate giants among its clients, says it is hard to find good teachers who understand both technology and business. He should know. The school's first attempt to run such courses ten years ago flopped because the teachers weren't good enough.

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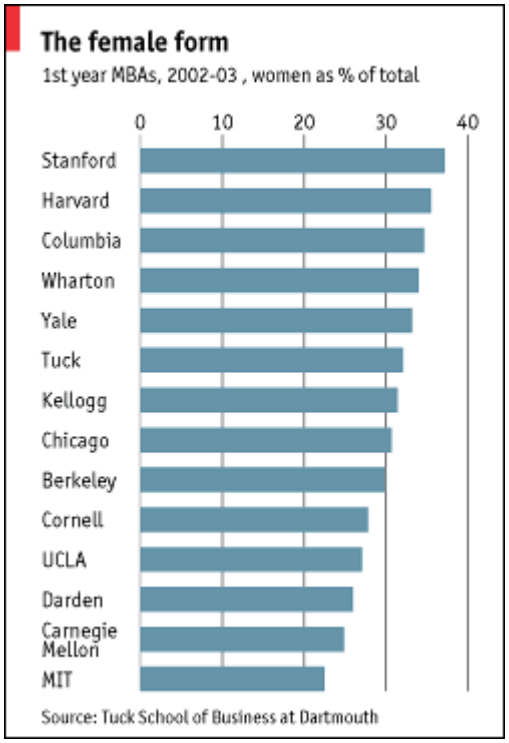
Women and MBAs

Men's work?

Jun 12th 2003
From The Economist print edition

Why more women don't go to business school

Get article background



WHERE have all the women gone? Plenty to law school and medical school, where they typically equal, at least in America, the number of men. But business school? Here is an oddity. Business schools have bust a gut to persuade women to take MBAs, but with disappointing results. In 1988-89 women accounted for 28.6% of first-year students enrolled on MBA programmes at the 20 schools that topped *Business Week*'s annual ratings; in 2002-03, 30.3%. This year, says Kristine Laca, head of admissions at the Tuck business school at Dartmouth, women's enrolments are down right across the industry.

The disappointing numbers are not confined to America. At the London Business School, 26% of current first-year MBAs and 29% of second years are women. Everywhere, numbers are low despite strenuous efforts by many business schools to attract more women.

A group of business schools and companies has reacted by setting up the Forté Foundation, based at the University of Michigan, to try to discover why more women do not apply. One issue seems to be cost, says Jeanne Wilt, who established the foundation. A two-year MBA course at a top school typically costs about $100,000, even without counting lost earnings. Some women will forgo a place at a top school for a full scholarship at a lesser school. Moreover, three to five years after leaving, women MBAs typically earn less than their male counterparts do.

Women seem to drop out of business careers in their 20s. At IMD in Lausanne, which usually takes students aged about 30 rather than (as at American schools) 26, only 16% of those on the one-year MBA programme are women. Yet IMD says it takes a representative proportion of women at the appropriate level in business.

Business also seems to have an image problem with women. “They worry that business is not a caring profession,” says Constance Helfat, Tuck's professor of strategy and technology. “But then, neither is law.” Ms Wilt says that women worry about long working hours, a lack of ethics and an absence of role models.

But could it be that women know something that men don't? After all, women get 30% of MBAs, but they own 38% of America's businesses. And they may soon own more. Ms Helfat thinks that women in business are more likely than men to start their own companies. Maybe the truth is that you can be a good businesswoman without an MBA—but not a good businessman.

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Oracle's bid for PeopleSoft

The next software battle

Jun 12th 2003
From The Economist print edition

Larry Ellison has seen the future, and there's no place in it for soft people

AP

Ellison drinks to a two-boat race

IT IS hardly surprising that PeopleSoft was not exactly overjoyed when Oracle, its big rival in the software business, launched a hostile $5.1 billion bid in cash for the company. Craig Conway, PeopleSoft's chief executive, reacted as is customary in an industry in which trading insults is part of doing business. He dismissed the offer as a "diabolical" attempt to sabotage the planned merger of his company with J.D. Edwards, another software firm.

But is Oracle's surprise bid on June 6th really just another example of the legendary recklessness of its boss, Larry Ellison? Perhaps he cannot bear the thought that his firm, because of the marriage of PeopleSoft and J.D. Edwards, will lose its second place in application software (see chart)—and possibly the chance of ever becoming number one. Then again, Oracle's offer could be based on a realistic, albeit somewhat worrying, vision of the future of the software industry.

Mr Ellison has long argued that his industry is maturing. Information-technology spending is unlikely to pick up much; most products are becoming commodities; and customers prefer to buy from large software firms offering integrated suites of programs, rather than from small specialists. All this, he predicts, will lead to a sweeping consolidation, in which hundreds of firms will disappear. The enterprise-software industry (ie, programs that tie together a supply chain, manage customer relationships and keep track of human resources) will be dominated, he suggests, by just two companies: Oracle, of course, and SAP, a German software giant.

Oracle's management has thought long and hard about how this vision could play out. Buying PeopleSoft is an option it had discussed—in particular since, a year ago, Mr Conway approached Oracle with an offer to pool both firms' application business (a deal that was never concluded because Mr Conway wanted it to be a separate business). J.D. Edwards was also on Oracle's radar screen. In fact, Oracle had contacted the firm shortly before J.D. Edwards and PeopleSoft announced their intention to merge on June 2nd.

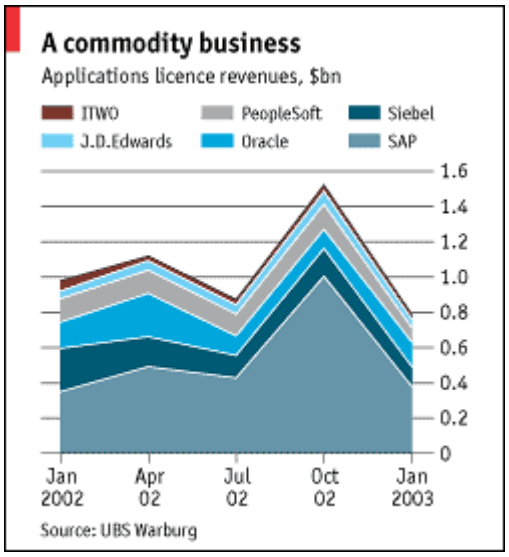
That announcement did not take Mr Ellison completely by surprise. Going directly for PeopleSoft, should the firm try to merge with J.D. Edwards, was a possibility that had been planned for—and one which some observers call nothing short of brilliant. For one thing, it means Oracle will avoid getting into a bidding war for J.D. Edwards. The offer also destabilises two competitors by, in effect, freezing their businesses. "If you're considering a purchase of J.D. Edwards or PeopleSoft products, don't sign a deal until it becomes clear whether Oracle's plans to acquire PeopleSoft are serious," Gartner Group, a consultancy, wrote in a memo to its clients.

What is more, PeopleSoft would be the better catch. More than J.D. Edwards, it would allow Oracle to gain market share in the application business. This is a must for the firm, since its applications suite has not taken off as planned and its bread-and-butter business of corporate databases is also maturing. More important in the short term, a takeover of PeopleSoft would boost Oracle's finances. Since it doesn't intend to continue selling PeopleSoft's products, it can cut costs while getting additional revenues from maintenance fees and upgrades.

Roughing them up

The plan to kill PeopleSoft would also help to avoid the usual pitfalls of technology mergers, such as losing talent because of cultural incompatibilities. Just like employees, customers are also likely to have a rough time, despite Oracle's promise to serve existing PeopleSoft customers better by extending support for the firm's older products and offering free upgrades.

Even if the takeover makes sense, at least for Oracle, it may still not happen. Mr Ellison will have a hard time persuading PeopleSoft's management not use its “poison pill”, a mechanism to make an acquisition much more expensive. The bid may also run into antitrust problems. And Oracle will have to sweeten its offer. The $16-a-share offer is only about 6% above PeopleSoft's share price on the day that Oracle launched its bid. It might have to go as high as $20. In anticipation of Oracle's need for cash to complete the deal, Moody's downgraded the company's credit rating.



In the end, shareholders will have to decide whether they want Oracle's cash or whether they trust the managements of PeopleSoft and J.D. Edwards to turn two struggling software firms into a force that is able to compete with Oracle and SAP, as well as Microsoft. The odds that other bidders will emerge are low. None of the big names is likely to play a white knight: doing so would either clash with their business models (IBM), or raise antitrust issues (Microsoft), or go against a policy of not making big acquisitions (SAP).

The fight between Mr Ellison and Mr Conway could be as dramatic as last year's battle over the merger of two computer makers, Hewlett-Packard and Compaq. After it backed away from filing a lawsuit this week to try to block the bid, PeopleSoft's board now has to respond. Oracle hopes that its quarterly results will help its offer. The company, which was scheduled to announce earnings as *The Economist* went to press, is likely to meet or exceed expectations. PeopleSoft, whose results are due in July, is in another difficult quarter, not least because of Oracle's bid.

Even if the takeover fails, Mr Ellison's vision may still come to pass. The offer has already led to speculation about what will happen to other software firms, in particular Siebel Systems. Conversely, even if the offer succeeds, it does not mean that Oracle will reign supreme. Many IT customers may opt for SAP because they worry that Oracle wants to become the Microsoft of enterprise software. One day, not only Mr Conway may be talking of “atrociously bad behaviour from a company with a history of atrociously bad behaviour”.

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Face value

Clean Breen

Jun 12th 2003
From The Economist print edition

AP

Ed Breen has made quick work of sorting out Tyco's mess

YOU can spot the grasping hand of Dennis Kozlowski everywhere at the Manhattan headquarters of Tyco, an industrial conglomerate whose disgraced former boss conjures up everything that went wrong with American business in the late 1990s. Photographs of *Endeavour*, Mr Kozlowski's exotic, antique yacht, still adorn the office walls. Boardroom oil paintings display his pretensions as a collector of fine art. An executive kitchen, once staffed with two professional chefs, gathers dust. But while the physical traces of Mr Kozlowski linger, his legacy is fading fast. Only a year since he started cleaning up Tyco, the new boss, Ed Breen, insists that the businesses Mr Kozlowski built are in good shape.

When Mr Breen accepted the top job at Tyco in July 2002, the company was in crisis. After abandoning a botched attempt to break the firm up, Mr Kozlowski had been charged with evading taxes on his personal art purchases, and promptly resigned. As the company struggled to fend off accusations of dishonest accounting, confidence collapsed and suppliers demanded cash on delivery. With big debt payments looming, Tyco's bankers got jumpy. Wall Street's carnivorous short-sellers smelt blood.

Pushed to the edge, John Fort, a board director and former boss, took temporary charge and tried to redeem himself by finding the right man to replace Mr Kozlowski. Mr Breen, an ex-Motorola manager who describes himself as an “operations fanatic”, promptly confirmed Mr Fort's good judgment by sacking him—along with the rest of the board and Mr Kozlowski's inner circle of 50 managers. As details dribbled out of the breakdown of controls that had allowed Mr Kozlowski to borrow hundreds of millions of dollars to buy property and other personal luxuries, Mr Breen cleaned up Tyco's corporate governance. He also reopened Mr Kozlowski's books.

The picture that emerged is of a company of many different pieces. At the heart of corporate Tyco in New York was a hyperkinetic mergers-and-acquisitions machine, where management controls vanished in the intoxicating 1990s. In some ways, Mr Kozlowski's team applied real discipline, handpicking thousands of firms to build strong market positions in dull and fragmented, but fast-growing businesses, chiefly medical equipment, plastics, fire and security systems and electronic components. “Tyco is pretty much number one or two in every market it is in,” says Mr Breen. “It owns all the powerful brands.”

But in other ways, corporate Tyco lacked discipline entirely. Top managers flagrantly abused the executive-loan scheme—actions that have since become the basis for criminal complaints. Even by the standards of the 1990s, salaries were outrageous. The head of human resources earned $2m a year, and annual bonuses ran to seven times basic pay. On the other hand, the “Dennis thing”, as Mr Breen calls it,

did not spread beyond Mr Kozlowski's inner circle. At the operating level, Mr Kozlowski remained thoroughly parsimonious. Once acquired, Tyco's businesses were given a brutal, one-off round of job cuts, then left to fend for themselves.

Nor, despite the exhaustive efforts of short-sellers and their friends in the media, is there evidence that Tyco's accounting was particularly deceitful. In December, an independent investigation reported no evidence of systematic accounting fraud at the firm. What Mr Breen describes as an “aggressive” internal audit of all Tyco's 2,150 operating businesses ended in April with a $1.5 billion charge to earnings. Of this, says Mr Breen, one-third relates to new accounting policies at ADT, Tyco's main fire-and-security brand. Another third comes from a general shift to more conservative accounting. Only the remaining $500m, says Mr Breen, consists of “mistakes” in Tyco's accounting between 1997 and 2002—a modest tally, by recent yardsticks. In all likelihood, the Securities and Exchange Commission will soon end its investigation of Tyco's books without taking any action.

Meanwhile, the government's routine audit of Tyco's tax filings should hold few terrors. Despite its offshore incorporation in Bermuda, Tyco's effective tax rate is still a relatively high 28%, suggesting that its tax-planning strategies were not excessive. The only big unknown facing shareholders is the potential damage from class-action lawsuits.

Down to detail

After obtaining fresh bank loans and selling new bonds in January, Mr Breen has now turned to managing Tyco's assets. He has made some big changes, ripping out the old team at ADT and splitting the plastics group into a separate business. By and large, however, Mr Breen will spend the next year working on the sort of detail that Mr Kozlowski neglected. Tyco buys $14 billion-worth of goods and services a year, but has no central purchasing department. Production is spread among too many factories. There is no company-wide strategy for information technology. Four headquarters (in New York, Bermuda, Florida and New Hampshire) will shrink to two.

In the medium term, says Mr Breen, the industries that attracted Mr Kozlowski should give Tyco annual sales growth of some 4-6%. Greater efficiencies should turn this into profit growth of 10-12%. As Tyco's businesses throw off cash, Mr Breen will pay down debts and rebuild creditworthiness. By the start of next year, he hopes to have restored the lustre to management—and to the share price.

After that, Mr Breen must wrestle with the same sorts of choices Mr Kozlowski faced to squeeze growth out of mature, industrial assets. Interestingly, he points to the same conclusion as the old rogue himself: buying yet more businesses to keep the process going. By this time next year, if all goes well, Mr Kozlowski's old M&A machine could have spluttered, in a modest way, back to life.

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Aircraft and bribery

Airbus's secret past

Jun 12th 2003
From The Economist print edition

Flight Collection

On the eve of the Paris Air Show, we explore the corrupt and allegedly corrupt methods that have boosted past sales

Get article background

IN SEPTEMBER last year, a fraud squad, led by Jean-Claude Van Espen, a Belgian magistrate, raided Airbus's headquarters in Toulouse. “They wanted to check whether there was possible falsification of documents, bribery or other infractions as part of the sale of Airbus aircraft to Sabena,” says Mr Van Espen's spokesman. The team of 20 Belgian and French investigators interviewed several Airbus employees during its three-day stay in Toulouse and carted away boxes of documents.

In November 1997 Sabena had approved an order for 17 Airbus A320s (narrow-bodied aircraft) which it did not need. Even more oddly, it had doubled the order at the last minute to 34, a move which helped trigger the airline's collapse four years later.

Though nominally controlled by the Belgian government, Sabena was run by the parent company of Swissair, SAirGroup, which had owned a stake of 49.5% since 1995 and which also went bust in 2001. A former Sabena manager, who arrived after the Airbus order was placed, says that the planes were not needed: “It was a fatal business decision.” A Belgian parliamentary commission's recent report confirms that the Airbus order was a big cause of Sabena's collapse.

Mr Van Espen's separate criminal investigation is continuing. According to the report, it started in October 2001 after Philippe Doyen, then a Sabena employee, lodged a complaint. Among other things, he suggested to Mr Van Espen that he interview Peter Gysel, a former Swissair employee now working at Airbus, who put together Sabena's deal with Airbus. Mr Gysel denies any impropriety. The former Sabena manager says: “I never got the slightest whiff that the decision was driven by kickbacks, side-payments and so on. But I cannot rule anything out.” Neither does Mr Van Espen.

Today airlines are ordering about 400 aircraft a year. But in good times 800 planes, worth around $60 billion, are sold a year. In the past ten years Airbus (originally a consortium, now owned 80% by EADS and 20% by BAE Systems) has caught up with Boeing, which had enjoyed two-thirds of the market since its 747 jumbo-jet entered commercial service in 1970.

Many aircraft are no doubt bought and sold in entirely conventional ways. But many are not. After all, lots of airlines are still state-owned and not subject to normal business rules. Commission payments (licit or illicit) on multi-million-dollar aircraft deals increase the capital cost of aircraft, which are therefore subject to higher depreciation or operating-lease charges, or both. But these extra costs are barely

discernible in the pool of red ink created by the carriers' perennial losses.

Aircraft purchases drag on for years, as airlines play Boeing and Airbus off against each other. Especially in a buyer's market, deep discounts are common, performance guarantees are demanding and manufacturers have to offer all sorts of sweeteners (for instance, aircraft trade-ins, or unusual guarantees) to persuade an airline to switch to their aircraft.

Unsurprisingly, given the regulated nature of international air travel, politics plays a part. For instance, no sooner had Air Mauritius bought Airbus A340S in 1994 than it obtained an upgrade from Paris Orly to Charles de Gaulle airport, which is Air France's main base with better onward connections.

Aircraft purchases have long been associated with controversy. In the 1970s, when Lockheed was still making civil jets, it was caught bribing Japanese officials to buy its L1011 wide-bodied airliner. A Japanese prime minister was later charged and convicted in 1983 for taking a bribe. Prince Bernhard of the Netherlands was also disgraced for his involvement with Lockheed. This scandal led in 1977 to Congress passing the Foreign Corrupt Practices Act (FCPA), which forbids American companies, their officers or their representatives from bribing foreign officials.

Critics (including this newspaper) have often pointed out that American firms can side-step the FCPA by using foreign subsidiaries and nationals to pay bribes. Boeing says that its policy is to adhere to the spirit and letter of the FCPA, that its systems of controls ensure employees comply with this policy, and that no Boeing employee has been charged under the FCPA. In 1982 Boeing pleaded guilty to false statements about commissions on the sale of commercial aircraft prior to 1977. Boeing also says that there have been public hearings in the Bahamas over allegations of bribery in the 1990 sale of deHavilland aircraft to Bahamas Air, during Boeing's ownership of deHavilland.

Airbus has not been subject to such constraints. France ratified an OECD convention to outlaw bribery of foreign public officials in 2000. Until then the government even permitted French companies tax deductions for giving bribes.

For years, as they steadily lost market share to the European challenger, the Americans have been outspokenly critical of Airbus. In the 1980s the beef was the huge subsidies that European governments poured into the industry. Now that Airbus repays such launch aid, that is less relevant, especially as Boeing receives indirect subsidies through America's defence budget and space programme.

But the American government has also spoken out on the subject of bribery. Two years ago Grant Aldonas, an under-secretary for international trade, told a congressional committee: “...unfortunately this [aircraft manufacturing] is an industry where foreign corruption has a real impact....this sector has been especially vulnerable to trade distortions involving bribery of foreign public officials.”

“...this sector has been especially vulnerable to trade distortions involving bribery of foreign public officials”

According to a European Parliament report, published in 2001, America's National Security Agency (NSA) intercepted faxes and phone calls between Airbus, Saudi Arabian Airlines and the Saudi government in early 1994. The NSA found that Airbus agents were offering bribes to a Saudi official to secure a lion's share for Airbus in modernising Saudi Arabian Airlines' fleet. The planes were in a $6 billion deal that Edouard Balladur, France's then prime minister, had hoped to clinch on a visit to see King Fahd in January 1994. He went home empty-handed.

James Woolsey, then director of the Central Intelligence Agency, recounted in a newspaper article in 2000 how the American government typically reacted to intelligence of this sort. “When we have caught you [Europeans]...we go to the government you're bribing and tell its officials that we don't take kindly to such corruption,” he wrote. Apparently this (and a direct sales pitch from Bill Clinton to King Fahd) swung the aircraft part of the deal Boeing's and McDonnell Douglas's way.

Kuwaiti kickbacks?

Not even the NSA, however, knows about everything in the aircraft-manufacturing industry as it actually happens. Consider the history of an Airbus order placed by Kuwait Airways Corporation (KAC), another state-owned airline.

In November 1995, Reuters reported that Kuwaiti prosecutors had questioned Bader Mallalah, KAC's then chief financial officer, over allegations of embezzlement made against him by KAC. The firm's chairman, Ahmed al Mishari, had suspended Dr Mallalah from his job the previous month. But KAC had trumped up the allegations against Dr Mallalah to put the lid on a story of corruption in which its then chairman was himself involved.

That story began exactly five years earlier in Cairo, where KAC had set up temporary headquarters after Iraq's invasion of Kuwait in August 1990. Most of its planes would inevitably be lost or damaged, so Mr al Mishari was planning a shiny new post-war fleet. Naturally, both Boeing and Airbus were asked to tender. Both firms expected politics to play a part in KAC's choice, especially after an American-led coalition had liberated Kuwait.

Shortly after the liberation of Kuwait, Boeing and KAC met in London. One person present says Mr al Mishari gave the impression that the order would be Boeing's. After all, until then, American companies had won most of the large reconstruction contracts from a grateful government.

Airbus hoped otherwise. In 1991, shortly before the Paris Air Show, Jean Pierson, the then boss of Airbus, met Mr al Mishari at the Churchill Hotel in London. The two talked in private for part of the time, so what they discussed is not known. Two clear inferences can, however, be drawn from subsequent events: Mr al Mishari promised the order to Airbus; and Mr Pierson pressed for an announcement at the imminent air show.

AFP

Jean Pierson, hands-on boss

As substantial public funds were involved, KAC was supposed to follow formal process in Kuwait before placing the order. This included approvals from the Ministry of Finance and the public-spending watchdog. None of these approvals was sought before the air show. In June 1991, at the show, Mr al Mishari stunned Kuwaiti officials and Boeing, when he announced a firm order for 15 Airbus aircraft, worth $1.1 billion, and options for nine more, worth up to $900m. A delighted Mr Pierson trumpeted the deal as Airbus's first single order for all its aircraft types.

Most unusually, Boeing was not asked for its “best and final” offer, according to a former KAC employee. Boeing's response to the announcement was to offer generous discounts to KAC—so that its package was around $100m cheaper than its rival's—but it was too late. The upshot of a meeting in the summer of 1991 between the boss of Boeing Commercial, furious American officials and the Crown Prince of Kuwait was a messy compromise. KAC would order the engines for the Airbuses from General Electric; Boeing would receive an order for two wide-bodied planes as a sop; and the firm order for 15 Airbus aircraft would go ahead provided that KAC bought from Boeing in future.

This left Mr al Mishari in a rather awkward spot. KAC had an option to buy nine more aircraft from Airbus. An airline is usually able to walk away from an option deal if it forfeits the modest deposit paid. But this case was far from normal. The company that was to take up the option was not KAC itself but a subsidiary, Aviation Lease and Finance Company (ALAFCO), which Mr al Mishari had set up in Bermuda in September 1992. ALAFCO was to buy the aircraft and lease them to KAC. In late 1992 Mr al Mishari confirmed to Mr Pierson that ALAFCO would buy the nine planes and sent off a $2.5m deposit. By buying the planes through ALAFCO, Mr al Mishari intended to bypass formal governmental approval.

There was more to the deal. Airbus chipped in a total of $450,000 between 1992 and 1994 to help with the costs of setting up and running ALAFCO. On December 15th 1992 ALAFCO appointed a part-time commercial adviser, Mohamed Habib El Fekih, a Tunisian national. His day job was then as head of sales in the Middle East—for Airbus. Under his ALAFCO contract of employment, a copy of which *The Economist* has and which was to run for three years from January 1993, Mr El Fekih received $5,000 a month, and $80,000 in back pay for “services” rendered to ALAFCO from February 1st 1990—31 months before ALAFCO'S incorporation—to December 31st 1992. The $5,000 was paid each month from ALAFCO's account number 201-901-04 at the Commercial Bank of Kuwait in New York to Mr El Fekih's personal account (number 0000003930B) at Crédit Lyonnais's branch in Blagnac, France, where Airbus is based on the outskirts of Toulouse.

By 1993 three of the nine aircraft under option, all cargo planes, were nearly ready for delivery. However, Dr Mallalah, who was also ALAFCO's chief executive, insisted that the transaction be subject to formal procedure in Kuwait. This meant competitive tenders from Airbus and Boeing. Unsurprisingly,

Airbus, with inside knowledge from its two-hatted vice-president, Mr El Fekih, was able to match exactly offers from Boeing, after Boeing came in over $50m cheaper. With nothing to choose between the offers, ALAFCO selected Airbus, on the grounds that KAC's fleet now comprised predominantly Airbus aircraft.

The deal sailed through KAC's board and the Ministry of Finance. However, Dr Mallalah provided Kuwait's public spending watchdog with full details of ALAFCO's order for the cargo planes. It refused to sanction the deal. Consultants concluded in early 1995 that the purchase of the cargo aircraft was not justified. The Ministry of Finance told KAC not to proceed. After Dr Mallalah submitted a report to KAC's board on the affair, Mr El Fekih resigned from ALAFCO in March 1995.

Mr El Fekih says that he acted in an honest way; Mr Pierson approved his ALAFCO contract, as did the boards of KAC and ALAFCO; his ALAFCO contract had nothing to do with the sale of Airbus to KAC; KAC cancelled its option; ALAFCO never bought any Airbus aircraft; he acted as a consultant to help set up ALAFCO as an aircraft-financing company; and he declared his earnings to the taxman. Airbus says that it offers this sort of support to customers, when asked. The present owners of the ALAFCO business confirm that ALAFCO bought three Airbus aircraft.

Of the other six aircraft under option, three were not converted into firm orders. Two Airbus A320s were leased to Shorouk Air in Egypt. This joint-venture between KAC and EgyptAir was specifically set up to find a home for them, but is being liquidated because of massive losses. Kuwait's Ministry of Finance leased another.

Mr al Mishari, sacked as the chairman of KAC in 1999 after spending almost his entire career with the airline, owns a shopping complex in the Salmiya district of Kuwait, which local wags have dubbed the “Airbus Centre”. Mr al Mishari, whose family is wealthy, suffered financial problems when the Kuwaiti stockmarket collapsed in the early 1980s. Mr al Mishari declines to comment, as does KAC.

It is not irrelevant to ask if the price of the Airbus aircraft was inflated to allow for kickbacks. No evidence of graft has ever come to light. However, no policeman, in Kuwait (or elsewhere), has looked for any.

India ink

What about cases where police have carried out investigations? In March 1990 India's Central Bureau of Investigation (CBI) filed a first information report (FIR). It was investigating allegations that Airbus had bribed highly placed public servants and others to induce Indian Airlines (IA) to order its aircraft.

In March 1986 state-owned IA had ordered 19 Airbus A320s, worth $952m, with an option for 12 more, later exercised. This was despite the fact that, when IA set up a committee in 1983 to recommend replacement aircraft for its ageing Boeing fleet, the A320 was not considered—it had not then been launched or flown. With approval from the Indian government, IA had in July 1984 paid Boeing a deposit for 12 Boeing 757s, large narrow-bodied aircraft.

Several civil servants and IA officials were named in the FIR. One name not on the list was that of Rajiv Gandhi, India's prime minister in 1984-89, who was killed in a bomb explosion in May 1991.

How has the CBI's investigation progressed in the intervening 13 years? Hardly at all, despite the hounding on public-interest grounds of the CBI in Delhi's High Court since 1998 by B.L. Wadehra, an anti-corruption lawyer based in Delhi. *The Economist* has examined the publicly available court documents—the CBI's status reports on its investigation are secret— from Mr Wadehra's litigation.

These papers allege, first, that in October 1984, weeks before Mr Gandhi, a former pilot, succeeded his mother, IA received an offer from Airbus for A320 aircraft, a smaller and less expensive plane than Boeing's 757. It required urgent attention. Second, that in November, the aviation ministry gave IA just three days to appraise the offer for Mr Gandhi's office.

Much later, in 1990, *Indian Express*, an Indian newspaper, reported a leaked manuscript note which showed that Mr Gandhi had decided at a meeting on August 2nd 1985 that IA “should go in for Airbus A320 aircraft”.

Mr Gandhi's correspondence file on the deal mysteriously vanished. The court papers show that civil servants reconstructed 29 pages of the missing file for

Rajiv Gandhi

the CBI by obtaining copy correspondence from government departments. Remarkably, this task took seven years—and even then the reconstruction was only partial.

After the green light from Mr Gandhi, approvals from IA and government bodies were a formality. For instance, the IA board approved the Airbus order at a meeting on August 30th 1985, which started at noon. The quality of the analysis presented to the board on the competing offers was pitiful. The board considered only one criterion—comparative fuel efficiency. Even for that, the data were incomplete. The A320 with the engine chosen by IA had yet to be tried and tested anywhere; provisional data only were included in the report for Boeing 737s "since no technical data supplied by the company".

decided in 1985 that Indian Airlines "should go in for Airbus A320 aircraft". His correspondence file on the deal mysteriously vanished

But Boeing had not been asked for any. This was because two hours before the board meeting, at 9.50am, IA's managing director, who is named in the FIR as an alleged recipient of kickbacks, received a letter from Richard Elliott, then Boeing's regional sales director. Boeing offered to supply up to 35 of its 737 aircraft, its narrow-bodied rival to the A320, with a discount of $5m per plane. This would reduce IA's investment in new planes by $140m, stated Mr Elliott. IA's board brushed the offer aside on the grounds that "if Boeing was [sic] too serious...they [sic] could have made the offer earlier".

The Delhi court has a withering opinion of the help Airbus has given the CBI. It allowed Mr Wadehra to add Airbus's Indian subsidiary to his action on the grounds that Airbus in France was not co-operating. Airbus told Mr Wadehra that French law forbade it from answering his questions. "[Airbus] sells its aircraft on their merits," the firm insisted.

The court has castigated the CBI for its dilatory approach. It took the Indian authorities until 1995 to contact Airbus for information, only to be told that such requests should be routed through the French government. The CBI told Mr Wadehra, despite trying Interpol and diplomatic channels, it was not getting any help from the French government. The French embassy in Delhi in effect told Mr Wadehra to get lost when he wrote to ask why France was not co-operating.

Mr Wadehra's case is now topical. This is because in March last year, IA's board approved an order for 43 Airbus planes, worth around $2 billion. The order now needs government approval. However, in September 2000, the Delhi court ruled that the Indian government should not approve further purchases from Airbus until the CBI had obtained the information it wanted from the French.

The upshot of the IA story is that no serious attempt has been made to establish whether or not Airbus paid kickbacks to Mr Gandhi and associates. The CBI has not answered our written questions.

Mounties and banks

But there are police forces which have shown rather more resolve and initiative than the CBI. One important case establishes that Airbus has paid "commissions" to individuals hiding behind shell companies in jurisdictions where ownership of companies is not a matter of public record, and where strict bank secrecy applies.

Airbus's first big sale in North America was a $1.5 billion deal, signed in 1988, to sell 34 aircraft to the then state-owned Air Canada. The middleman was Karlheinz Schreiber, a German-Canadian with connections to politicians in Germany and Canada. Mr Schreiber emerged as a figure in the financing scandal that engulfed Germany's Christian Democrat party and its top politician, Helmut Kohl, a former chancellor, in the late 1990s.

In August 1999 the Royal Canadian Mounted Police, acting on a German arrest warrant, nabbed Mr Schreiber. In 2000, Mr Schreiber was charged in Germany with tax evasion on money he had received for the Airbus transaction and other deals. The *Süddeutsche Zeitung*, a German daily, has supplied a copy of Mr Schreiber's indictment to *The Economist*. According to this document, Airbus signed a consultancy contract (amended four times) with International Aircraft Leasing (IAL) in March 1985. IAL, which was to help with the Air Canada deal, was a shell company based in Vaduz, Liechtenstein, and a subsidiary of another Liechtenstein-registered shell, Kensington Anstalt.

According to the indictment, between September 30th 1988 and October 21st 1993 (ie, as Air Canada took delivery of Airbus planes), Airbus paid a total of $22,540,000 in "commissions" to IAL. $10,867,000

was paid into IAL's account number 235.972.037 at the Verwaltungs-und Privat-Bank in Vaduz and $11,673,000 into IAL's account number 18.679.4 at Swiss Bank Corporation (SBC) in Zurich. During extradition proceedings against Mr Schreiber in 1999, Airbus admitted to these payments. In October 2000 Mr Schreiber won a suspension of execution of his case.

The court ruled that IAL belonged to Mr Schreiber, but also that, to the extent that Mr Schreiber had paid out the Airbus "commissions" as *Schmiergelder* ("grease monies"), these payments could be tax deductible. Mr Schreiber's German tax lawyer later told the court: "*Schmiergelder* were not openly paid to the 'greased' person by [Airbus]. It was through third persons to make reception anonymous and the *Schmiergelder* unrecognisable as such."

"Schmiergelder ["grease monies"] were not openly paid to the 'greased' person by [Airbus]. It was through third persons to make reception anonymous"

So who got the commissions? After years of police investigations in at least five jurisdictions, it is still not clear. According to "The Last Amigo", a well-researched book on the affair by Harvey Cashore and Stevie Cameron, both Canadian journalists, a lot was withdrawn in cash. Mr Cashore, a producer on "the fifth estate", Canadian Broadcasting Corporation's main investigative programme, says that Mr Schreiber's bank records and diaries showed that he usually followed a simple formula for dividing up the money: half for Canadians and half for Europeans.

The book alleges that there may have been a smaller scam within the bigger scam: an Airbus employee may have got some of the money. Some of the money was transferred into sub-accounts at SBC in Zurich. One of the sub-accounts, code-named "Stewardess", received as much as one-eighth of the commissions. The book suggests that this account was intended for Stuart Iddles, Airbus's senior vice-president from 1986 to 1994.

Mr Iddles's wife bought Casa Las Estacas, a luxurious beach-front villa in Puerto Vallarta, Mexico, in September 1992. Documents in *The Economist*'s possession show the price was $1.5m. According to a person involved in the deal, the money was wired from account number 154963-01-10 in the name of the Ciclon Foundation at the Zurich branch of Lloyds, a British bank. Mrs Iddles confirms that she bought the villa in 1992, but says she has not the "foggiest idea" how much it cost, or which bank the money came from. Mr Iddles has denied any impropriety. Airbus says it has not been indicted in any jurisdiction over the Air Canada deal, or over any other sales. It adds that no investigator has found unethical behaviour on its part.

A Mexican idyll

Syrian scandals

Only one case of Airbus's colluding with a middleman apparently to bribe officials to buy its aircraft has led to convictions. According to Syria's state news agency, three people were sentenced in Syria in October 2001 to 22½ years imprisonment each (later reduced to ten years) for "serious irregularities" in connection with state-owned Syrianair's order for six Airbus A320s in 1996. The court also imposed a fine on the three of $268m. They were a former minister for economic affairs, a former transport minister, and Munir Abu Khaddur, the middleman. Mr Khaddur was sentenced in absentia, and is reportedly living in Spain. The court found that the men had forced the airline to buy the planes, worth $240m, and as a result Syrianair had incurred "big financial losses".

The only inferences to be drawn are: either there was a miscarriage of justice; or bribes were paid. If the latter, the news agency did not release details of how much the men embezzled. Quite why bribes would have been necessary is puzzling. Because America deems Syria to be a sponsor of terrorism, Boeing has long been prohibited from exporting there. The Syrian government declines to comment.

The result of our investigations into instances of corruption or alleged corruption by Airbus suggests that Mr Van Espen will have a very long haul as he tries to establish whether "commissions" influenced Sabena's decision to buy Airbuses. The order for the 34 A320s could be viewed as incompetence. But nobody can predict the results of Mr Van Espen's inquiry.

The parliamentary report says Sabena's board received some lacunary information that was misleading.

The choice of Airbus supposedly meant Sabena was confident of strong sales growth. Yet a month after the order was placed, SAirGroup's chief executive, who also sat on Sabena's board, said: “We're now in the last year or years of the boom in air travel.” (We do not mean to imply by inference that the chief executive was corrupt.)

Most of what is recounted in this article happened before Airbus's present top management team arrived, before it was established as a proper company, and before France adopted the OECD convention on bribery.

No one doubts the company's ability to compete across the whole product range with Boeing. By the time next week's Paris Air Show is over, Airbus will probably be well ahead of its rival in market share, thanks to an attractive range of planes. But if charges of corruption involving Airbus were to emerge from Mr Van Espen's investigation of Sabena, that would deal the company's reputation a severe blow.

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Bond markets

The temptations of yield

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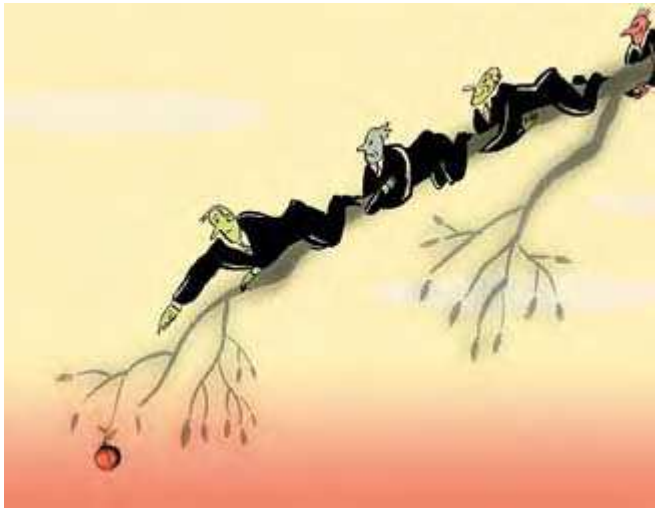
From The Economist print edition



Investors have been piling into riskier bonds. That way trouble lies

HOW short are the memories of financial folk. Like Japan's before it, America's stockmarket bubble was inflated on the back of a mountain of corporate debt. So onerous was this debt that many American companies were forced to the wall. Last autumn, fears about the sustainability of debts sent corporate-bond prices tumbling. In recent months, however, investors have been bidding up bond prices, to levels that are in danger of becoming as dotty as share prices once reached.

The prices of bonds, of all sorts and almost everywhere, have been rising as fears of deflation have mounted. Inflation erodes the value of an instrument that pays a fixed rate of interest and gives investors back their money at maturity, but deflation increases it. That is why yields on government bonds in Japan, which has been suffering from deflation since the mid-1990s, have fallen to a lower point than any recorded in history. Lenders to the Japanese government for 30 years currently enjoy a yield of just 1%; less than half that is available on ten-year bonds. Deflationary worries in Europe and America have pushed government-bond yields sharply down there, too. The yield on American ten-year notes fell this week to less than 3.2%.

As yields on government bonds have become thinner, investors have scurried to look for fatter returns elsewhere. In doing so, they have pushed the prices of bonds issued by riskier lenders up a lot faster than the prices of paper issued by rich countries' governments. Corporate bonds are a case in point. Credit spreads—the extra yield that these offer, compared with government bonds—have fallen by half since they peaked last autumn. On October 10th last year, the credit spread for investment-grade bonds over American Treasuries was 280 basis points (bps, or hundredths of a percentage point). By April, it was 135 bps, according to Bank of America. David Goldman, the bank's head of global markets research, believes that this is the fastest corporate-bond rally ever. Although investment-grade spreads have moved little since then, those of junk issuers have continued to tighten, from 1,100 bps in October to 730 now.

The same pattern can be seen in emerging markets. The spread of

J.P. Morgan's emerging-market bond index has fallen by almost half since early October, to 495 bps on June 9th. Yields are at a record low. Of all the bonds in the index, only those issued by the Dominican Republic have suffered a widening spread. Bonds from Brazil, which does not have an unsullied default record, have zoomed in from 2,300 bps over American Treasuries to 730. The spread on Russia's 30-year bonds is now four percentage points less than it was before the country defaulted in 1998.

The fall in borrowing costs may be a boon to a world economy that is still far from robust. Investors, however, have not been buying higher-yielding bonds out of altruism. So why are they keen? Their eagerness is explained mainly by a perceived lack of alternatives, given equities' riskiness and low rich-country government-bond yields. Even though the torrent has slowed, inflows into retail bond funds all over the world, but especially in America, remain high.

Institutional investors have also been on a buying spree. The liabilities of pension funds and insurance companies are generally high and fixed. As interest rates fall, the present value of these liabilities increases. Until the bubble burst, the need to earn a high return to offset these liabilities lured many such institutions into the stockmarket. Now that the stockmarket crash has exposed the risks of hedging fixed liabilities with floating assets in the form of shares, they are increasingly choosing corporate bonds instead. Thus, 13 years after the bubble burst, Japanese insurers are at last speeding up sales of equities in favour of corporate bonds.

Certainly, the risk of buying corporate bonds seems to have fallen. Default rates have dropped dramatically. Last year, 2.95% of outstanding American investment-grade corporate bonds went into default, a higher proportion than at any time since the Depression. So far this year there have been no defaults at all. There has been a less dramatic, but still marked, drop in junk defaults. This matters because buyers of corporate bonds in effect receive interest payments in return for the risk, however remote, that the borrower will default. The higher the risk, the higher the interest rate. Broadly, two things have reduced the perceived risk of default.

The first is that economic uncertainty has fallen: at any rate, the VIX, an index of volatility used as a proxy for systemic risk, has fallen by half since October. The second is that, measured by market prices, leverage (the ratio of companies' debt to equity) has fallen as share prices have recovered. Some companies have also made efforts to cut it. The pain inflicted by punitive and unsustainable interest rates last year caused many of the worst-affected companies to sell assets to pay off debt or even to raise fresh equity. Moreover, after the corporate scandals of the past couple of years, managers have learnt that there is a limit to investors' appetite for the boosting of profitability with borrowed money.

Indeed, in recent months bond and equity markets have fed off each other's optimism. Usually, say those in the markets, bond prices take their cue from equities. That is still true, but this time stockmarkets are being pushed along partly by the signals sent out by the corporate-bond market that companies are safer than they were only a few months ago. The result is an upward spiral in both.

In the bond market, at least, the spiral looks a little giddy. The numbers are not as reassuring as investors seem to think. Defaults have fallen, but that is largely because borrowing costs have fallen: it is a product of the bond-market rally, not a basis for it. There is little sign that leverage has fallen when measured by book value: although some companies have cut debt and raised equity, many have not. And now bosses' feet are no longer being held to the fire by high interest rates.

Rating agencies are still strikingly gloomy. In the first five months of this year, Moody's downgraded almost twice as many junk, non-financial, American issuers as it upgraded. Among investment-grade firms, the downs outnumbered the ups by 72 to three.

Small wonder, really. Deflation, fear of which has helped drive the government-bond rally, spells trouble for companies. It makes profits harder to come by and increases the real value of debt. These low yields should really be a warning to corporate-bond buyers. If central banks lose the battle against deflation, defaults will rise. And if they win, and inflation and then interest rates rise swiftly? Bad news too, for that may also push up default rates. Investors could be damned both ways.

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Bank branding

Name theory

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Investment banks' names get shorter

ONE by one, the names of once-glorious investment banks are being dropped by those who expensively bought them. This week UBS dispensed with the Warburg name for its European investment bank and PaineWebber for its American one. Both will be known only as UBS. In advertisements the bank reassured clients that, since it had only one aim—to understand their needs and help them make the right financial decisions—one name was enough. Customers doubtless wept for joy.

Just as name inflation gathered pace in the go-go 1990s, so deflation has become *de rigueur* in these more straitened times. A year ago Morgan Stanley Dean Witter became Morgan Stanley again. This April Salomon Smith Barney, Citigroup's investment bank (known in Europe as—deep breath—Schroder Salomon Smith Barney), became plain Citigroup. The Smith Barney name will live on as the group's independent research outfit, for which thank regulators. But the Salomon name has now gone the way of some of the businesses it once advised.

Why now? It is, after all, an expensive business to change all those legal structures, business cards, letterheads and logos, although banks won't say how much it has cost. And the acquisitions were not recent: both UBS and Citigroup were created five years ago. There was perhaps some residual value in the names. In the 1970s Salomon was pre-eminent, with the best investment bankers, the best research and the best traders. Its attitude to risk-taking was legendary, though not, it turned out, always legal: it was hit by a Treasury-bond scandal in 1991. S.G. Warburg was in many ways the antithesis of Salomon and the closest that Britain ever came to an international investment bank. It had little presence in America, less talent for trading, almost no bond business and a singular inability to make money for anybody but its employees. Perhaps that is why it is remembered so fondly.

Certainly, investment banks' bosses need to do something to earn their money besides sacking people. But the truth may be that banking brands have become so devalued that any break with the past is welcome.

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Freddie Mac

Trouble at home

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Uneasy times for one of America's vast mortgage underwriters

AFTER so many tales of scandal and sharp practice in corporate America, June 9th brought the familiar signs of yet another. The top three executives of Freddie Mac, a quasi-public, quasi-governmental company that underwrites 15-20% of America's mortgage market, departed abruptly. The stated cause was problems revealed by an audit begun a year ago, after Freddie Mac was forced to hire a new accountant to replace Andersen, the firm destroyed by its shoddy work for Enron and others.

The plot has many of the usual features: missing documents; lavish executive pay; unco-operative directors; and indications that Freddie Mac's reported figures are wrong and its internal controls are in chaos. Congress announced that it would hold hearings on the company's accounting. The wire services reported that the usual assortment of investigators, both civil and criminal, were on the case. To round off the script, Freddie Mac's share price plunged when the executives' departures were announced.

There, however, similarities with the normal plot cease. The markets' panic subsided quickly. The spread between the yield on Freddie Mac's bonds and that on Treasuries widened by only a few basis points. Within 24 hours, Freddie Mac's shares had rallied a bit.

Yet to Freddie Mac's many long-standing critics, this recovery was as worrying as the whiff of scandal. The company's resilience stemmed in part from its claims that its restated profits, when they emerge, will show higher, not lower returns. This is quite plausible, given the nature of Freddie Mac's business. It buys mortgages from lenders, using money raised by issuing bonds. In all it holds $1.3 trillion in mortgages. With interest rates declining, it is not surprising that it is doing well. But hold on. If Freddie Mac has benefited from falling rates, then it is surely vulnerable to rising rates. That may disturb investors who believed that Freddie Mac had hedged its portfolio cleverly, putting behind it the days when its fortunes rose and fell with the bond market.

And another thing: if Freddie Mac is doing well, why did three executives have to go? One hypothesis is that the company had become unable to value its increasingly complex portfolio of securities. Besides mortgages, this includes more than $1 trillion in derivatives and a hotch-potch of specially structured notes. The sharp drop in interest rates has also brought a wave of mortgage refinancing. If this was greater than Freddie Mac had prepared for, the maturity structures of its assets and liabilities may be misaligned.

Such concerns will be alleviated only when Freddie Mac issues new financial statements. These have already been delayed, and are now vaguely pencilled in for the third quarter. With all the investigations, thinks Bert Ely, an analyst in Washington, DC, it may take even longer.

Freddie Mac has been helped by its odd corporate structure. Unlike other lenders, both it and its larger sibling Fannie Mae were created by the federal government and then privatised. Like most other big private companies, their shares are traded on the New York Stock Exchange, and their bosses are paid royally. Freddie Mac's departing chief executive is due for a payout of $24m. Yet the companies have retained public-sector perks. They do not pay state or local taxes, giving them a competitive edge over banks. Nor are they subject to the same disclosure requirements.

Most important, the financial markets still think their debts are backed by the federal government. Freddie Mac thus receives financing for its loan and derivative portfolios on almost the same terms as Uncle Sam. “Our senior unsecured ratings are primarily based upon the political support for its debt,” says Michael DeStefano of Standard & Poor's, a credit-rating agency. Should Freddie Mac take too many risks and blow up, taxpayers, not shareholders, will probably foot the bill.

Because of this, the market's faith in the willingness of the government to bail out Freddie Mac has grown with the size and complexity of the company and its associated risks. “It is too big to fail, and too big to even look like it could fail,” says James Grant, of *Grant's Interest Rate Observer*, a Wall Street newsletter.

Nonetheless, says Mr Grant, this week's departures could mean the end of Freddie's “imperial” phase. Inevitably, “it will be given less rope to hang itself and ourselves.” That means it will either have to be absorbed back into the government, or, far more likely, be forced to operate more like an ordinary company. That would drive up its financing costs, shed more light on its activities and its accounts, and take a toll on its growth. Freddie Mac has strong political ties, so change will not come easily. Even so, change now would be far less painful than a disaster later.

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Exchanges

Banks beaten

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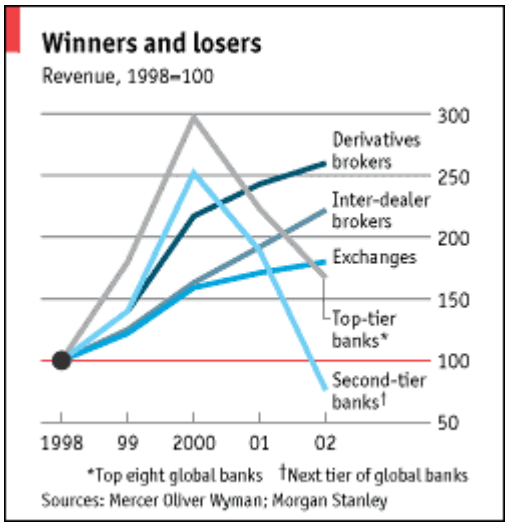
Trading platforms outshine bank business models

ESPECIALLY in Europe, exchanges are thriving, despite the bearishness of most stockmarkets. They are likely to attract increasing turnover; and they could even benefit from pending European legislation. European exchanges' combined revenues grew to *euro*5.2 billion ($4.9 billion) in 2002, while their North American counterparts generated $4.5 billion. Meanwhile, banks saw equity-trading revenues fall sharply between 2000 and 2002. Banks outside the first division suffered especially. Why?

A study by Mercer Oliver Wyman, a consultant, and Morgan Stanley, an investment bank, suggests that all these changes are down to an increase in automated equity trading, which attracts less brokerage commission but pumps up turnover on exchanges. The chief protagonists are hedge funds, particularly in America, where they account for over 40% of share trading. Automated funds, whose trading is driven by computer models, account for about 30% of share trading in the United States. That activity is likely to expand in Europe too, where it accounts for only 3% so far.

According to the study, the best thing to be at the moment is a specialist derivatives broker, or an inter-dealer broker specialising in bonds and derivatives that are traded off-exchange (see chart). The next best thing is an exchange, preferably with captive clearing and settlement attached for added revenue. Banks are flagging.



Global investment banks, which did so well until the bubble burst, are now looking enviously at the exchanges' steady volume growth. To add insult to injury, several exchanges have recently put up their charges. The top-tier banks can at least console themselves that they have relationships with hedge funds that are driving the market; second-tier banks cannot.

The best-placed exchanges are those which enjoy diverse revenues from cash and derivatives trading, clearing and settlement, and the sale of technology and market information. On this score, two European exchanges, Deutsche Börse and Euronext, provide the model. This is often referred to as a vertical silo. However, the study predicts that users' and regulators' insistence on fairer access at each stage of a transaction will make each silo look more like “the leaning tower of Pisa”.

There is much legal wrangling ahead. The governance of the New York Stock Exchange and NASDAQ, America's second stock exchange, are under scrutiny. In Europe, on the other hand, amendments to a new draft investment-services directive may work in exchanges' favour, by imposing more obligations on banks. The Italian and, to some extent, German authorities are fighting gamely on behalf of their national silos. Their pretext is the protection of the small investor: they want banks to make clear the terms of retail trades they execute internally; and they want advice to be made compulsory for small customers' trades (whether clients want it or not). A final discussion on amendments is expected next month, followed by a vote in the European Parliament in September. The directive could be passed by early next year—though it will take longer to be transposed into national law.

Investment banks, aware that the margins of the 1990s may have gone for good, are fighting against the erosion of their businesses by exchanges, clearing counterparties, and central securities depositories. Some have protested at moves by Euroclear, a pan-European clearing and settlement house, to offer banking-like securities services. Yet tougher bank-capital rules and greater awareness of counterparty

risks are leading even these banks to place more business with exchanges and clearing houses. The hope is that new legislation will lead to fairer trading, not reinforcement of the exchanges' market power. But, as the Mercer-Morgan Stanley study notes, the unpredictable nature and unintended consequences of lawmaking are not to be underestimated.

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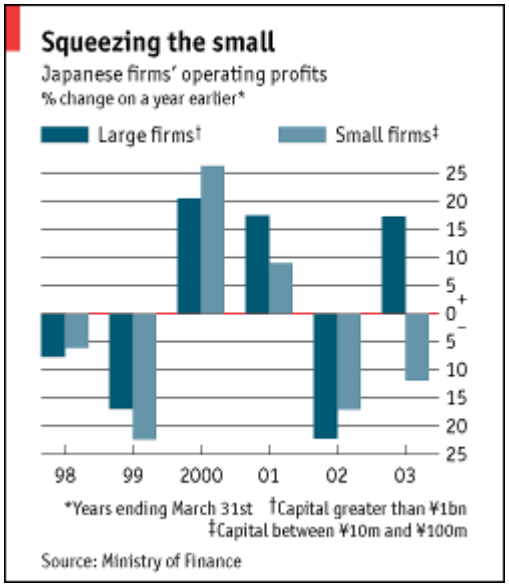
Japan's economy

Black ink

Jun 12th 2003 | TOKYO
From The Economist print edition

An upturn in Japanese profits is a rare bit of good news



HOW have they done it? Despite slow growth, deflation and much cynicism about Japan's efforts at economic reform, many of the country's listed companies have quietly begun to make money. Real GDP grew by just 1.5% in the year to March, according to revised figures released on June 11th. Falling prices have made the business climate tougher still. Yet on June 10th, the *Nikkei Shimbun*, Japan's leading business daily, released its tally of earnings at over 1,600 publicly listed companies, which have been reporting their annual results over the past several weeks. After losing money the previous year, non-financial firms managed in the year to March to make a combined net profit of ¥5.23 trillion ($44.4 billion).

Admittedly, this amounts to a trickle, not a flood. And in Japan, where progress rarely gains much momentum, good news is best treated cautiously. But the *Nikkei*'s figures for listed firms tell a similar story to data published by the Finance Ministry a few days earlier. These show that operating profits for "large" companies, a proxy for listed firms, rose by 17.3% in the year to March. This seems to be more than just a cyclical bounce. The main reason for rising profits is that many firms are now doing what they have been urged to do by economists and investors for years: restructuring themselves.

Falling share prices and other pressures from capital markets have prompted many firms to sell assets, shed excess workers and cut costs. One result is a wide gap between the performance last year of big and small firms (see chart). As large companies have weeded out suppliers and shrunk input costs, the smaller firms that they were supporting have felt the pinch. Whereas large firms' sales were roughly flat, those at small firms fell by 12.4% last year. Small companies' operating profits fell by 11.9%, according to the Finance Ministry's survey. On June 11th the central bank announced a new plan to buy securities that will help to keep small firms afloat.

Richard Jerram, chief economist at ING Barings in Tokyo, has compared the troughs of the past three business cycles—the years ending in March 1994, 1999 and 2002—and found that the biggest firms in most sectors are gaining market share at rivals' expense. This has helped to boost profit margins at the trough in 22 of 31 non-financial sectors, even though GDP sank by most, relative to potential, in the latest downturn. "A progressive improvement in profit margins of listed firms through successively deep recessions," Mr Jerram wrote recently, "is a likely sign of a structural rise in profitability."

However, these gains have been accruing slowly and will remain difficult to build on without a cyclical fillip. Since profit margins are still low, a small rise in sales would give earnings a big boost. But higher sales will be hard to achieve as long as deflation persists. Judging by their investment plans, companies are not yet optimistic. Until unprofitable firms are allowed to fail, the profitable will have to fight hard to keep the black ink flowing.

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Japanese finance

Unhappy returns

Jun 12th 2003 | TOKYO
From The Economist print edition

A costly week for ordinary Japanese

HAVING spent trillions of yen bailing out their country's ailing banks, Japan's citizens are being squeezed again in the name of financial reform—once as taxpayers, a second time as consumers. On June 10th the government confirmed that it would pour ¥2 trillion ($17 billion) of public funds into Resona, a bank that found itself short of capital last month. Two days later, after cursory debate, the lower house of parliament passed a new law allowing Japan's ailing life insurers to cut the rates of return they guaranteed to policyholders, and thus to break unprofitable contracts. This will slash future payouts to consumers, many of whom own several policies each.

It also points up the interdependence between Japan's struggling banks and life insurers. The beneficiaries of Resona's bail-out are its shareholders, which include several big, troubled life insurers. Without state help, their shares might have been worthless. Similarly, keeping weak life insurers alive helps the country's banks, which have lent large sums, often in the form of subordinated debt, to insurers. The new insurance law, expected to take effect next month, will force policyholders, who in bankruptcy proceedings take precedence over holders of subordinated debt, to lose out first.

Consumers can expect little reform in return. Although Resona's restructuring plan includes pay cuts, lay-offs and branch closures, analysts remain sceptical about its rosy profit forecasts and its promise to repay the government by—don't hold your breath—around 2019. Nor is there any sign that, in exchange for the cuts in guaranteed returns, life insurers will make their executives take responsibility for poor management.

There is also scant chance that the life insurers, most of which are mutuals, will be forced to make their finances more transparent. They will not be obliged to disclose how much of the gap between high payouts and low investment returns has been, or could be, made up without penalising policyholders—for example, by cutting costs or updating assumed mortality rates.

For policyholders, there is surely worse to come. Life insurers will be allowed to cut their guaranteed rates of return only to 3%, from around 5% now. With ten-year bond yields currently below 0.5%, this may not be enough to prop up the weakest. Further payout reductions look likely.

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Banking in China

Bad habits

Jun 12th 2003 | HONG KONG
From The Economist print edition

Who thought reform would be easy?

Get article background

ON MAY 28th, only a day before its shareholders' meeting, the Bank of China in Hong Kong, a subsidiary of one of China's four huge and troubled state banks, announced that its chief executive, Liu Jinbao, had resigned and moved to Beijing as part of a “routine transfer”. “Routine”, in the language of China's banking system, tends to mean anything but. Sure enough, on June 10th the bank formally admitted that Mr Liu had in fact been detained in Beijing, and was under investigation for corrupt lending to a Shanghai property tycoon, Zhou Zhengyi. Mr Zhou, hitherto best known for evicting thousands of residents in Shanghai to make room for his real-estate projects (many are suing him), is also in detention. Hong Kong's anti-graft police also took in Mr Zhou's wife for questioning.

Graft, bad lending: all this was supposed to be a thing of the past for China's banks, and Bank of China in particular. It made such headlines early last year, when it came to light that nearly half a billion dollars had been embezzled at one of its branches in southern China. Worse, Wang Xuebing, its former boss, was jailed for corrupt loans he had made during the 1990s from the New York branch, which he ran with some flamboyance. Mr Wang is now aiding the investigations against Mr Liu with advice from his prison cell.

At least, the Bank of China said at the time, all the bad news was coming out at once, thus allowing it to clean house and then list shares in a new, improved, and sparkling Hong Kong branch. This offering went ahead last July with moderate success, raising $2.8 billion. Foreign investors seemed to be giving the bank the benefit of the doubt.

That is why the current scandal is so embarrassing. Some of the dodgy transactions between the Bank of China (from its Shanghai branch, probably) and Mr Zhou seem to have taken place during the preparations for the share offering, precisely when the bank was supposedly cleaning up its act.

For those familiar with China's banking reforms, such setbacks are depressingly familiar. At the same time as the Bank of China's share offering, for instance, there was also optimism about what seemed to be a ground-breaking deal with an American finance firm, Newbridge Capital. Newbridge negotiated permission from municipal authorities in the southern city of Shenzhen, a progressive place by Chinese standards, to buy a stake in and take management control of a local bank. This was novel stuff: it implied that the government would allow foreign takeovers and would countenance lending based on borrowers' commercial rather than political credentials.

One year on, however, the deal is in limbo. Shenzhen's cadres, it seems, were not so keen to cede control of their bank after all; or they may have thought that they could haggle something better with a Taiwanese bank run by the Koo family, one of the island's most prominent. Newbridge, which was under the impression that it had signed binding contracts in Shenzhen, is suing the Koos in an American court.

As it has done many times before, Chinese banking has become bogged down in a quagmire just when it seemed to be making progress. Imagine, for instance, what Shan Weijian is going through. Mr Shan, a mainland Chinese, is Newbridge's man in Asia, and thus the fellow behind the negotiations in Shenzhen. As an international banking expert, a rarity in China, he was also invited to be an independent director of the Bank of China in Hong Kong.

Mr Shan is now working around the clock to douse the flames all around him. Which is ironic, because Mr Shan is well known for being pessimistic that China will ever respect private property and the sanctity of

contract—opinions that he formed during the Cultural Revolution, when he was doing hard labour in the Gobi desert—and so usually keeps Newbridge out of entanglements in China's state-owned sector. Now he has to help fix it. What else is one to do?

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Central European currencies

Inelastic bands

Jun 12th 2003 | WARSAW
From The Economist print edition

Wobbles on the way to the euro

Get article background

AS IF the financial conditions for entering the euro zone were not demanding enough already, central European countries now have even more to grumble about. Last month Pedro Solbes, the European Union's monetary-affairs commissioner, told them that, before they join the single-currency zone, they will have to keep their currencies within a narrow, 2.25% band either side of a central parity against the euro for two years, not the 15% they had previously envisaged.

For the Baltic states, who, like the central Europeans, are due to join the EU next year, the narrow band should be no burden, because they already operate fixed-rate regimes of one sort or another. The central Europeans, however, think that wider bands will help them see off speculative attacks like those that drove Britain and Italy out of the EU's exchange-rate mechanism in the early 1990s, which prompted a widening of the bands to 15%. Mr Solbes's insistence on a narrow band in the revamped mechanism, ERM2, puts a heavy premium on establishing a sustainable central parity.

Hungary, whose currency now moves in a 15% band against the euro, is wasting no time. On June 4th it devalued the forint by 2.3%, partly with its eye on a more favourable central rate in ERM2. But this was a risky move, given that Hungary has high inflation by regional standards (3.6%), a huge budget deficit (10% of GDP last year, maybe 6% this) and a large current-account shortfall (4.3% in 2002, and rising). Foreign investors, who own 45% of its government bonds, suspect that the government browbeat the central bank into devaluation at the expense of its inflationary credentials. Fearing a further drop in the currency, the central bank raised interest rates by a percentage point, to 7.5%, on June 10th. Monetary policy now looks confused.

Poland has even more reasons than Hungary to worry about currency speculation. Since the zloty was floated in 2000, its value has fluctuated a great deal. The Polish central bank harbours a number of closet unilateralists who would like to avoid the uncertainty of ERM2 altogether and adopt the euro at once. “In a [shallow] market like ours, one transaction alone can cause a 2% swing,” says Dariusz Rosati, a member of the central bank's Monetary Policy Council, which sets interest rates. He says Poland should insist on a wide band if it cannot skirt ERM2.

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Economics focus

Germany's euro test

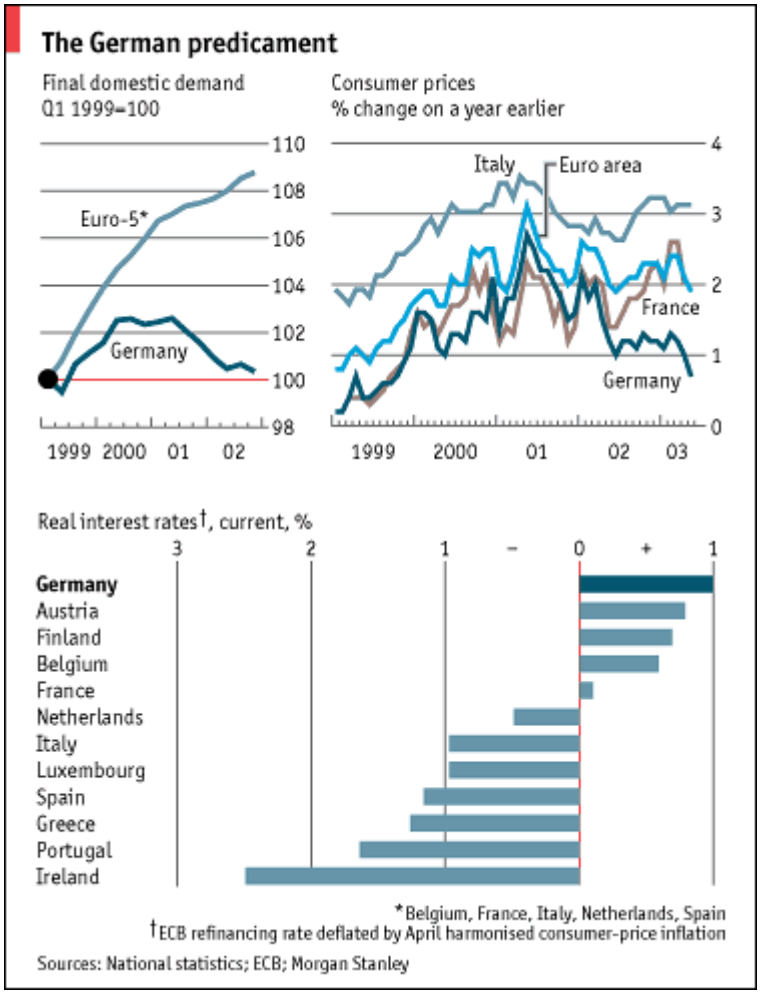
Jun 12th 2003
From The Economist print edition

A half-serious proposition

Get article background

THE interminable debate in Britain over whether to join the euro reached a new peak this week, when Gordon Brown, the chancellor of the exchequer, delivered his verdict. Mr Brown based his judgment on five economic tests, of which Britain, he announced, had failed four. Yet perhaps this is the wrong debate about euro membership. Only partly in jest, *The Economist* suggests that a better question is not whether Britain should join the currency zone, but whether Germany should leave.

Take Mr Brown's five tests and apply them to Germany. The first is convergence: are business cycles and economic structures sufficiently in step that Germany can live comfortably with euro-area interest rates? The clear answer is No. Since the euro was launched in 1999, Germany's GDP growth has been by far the slowest in the euro zone, causing its output gap (the difference between actual and potential GDP) to widen by more than anywhere else. Real domestic demand has barely risen at all in Germany since the start of 1999; in the rest of the euro area it has gone up by 9% (see chart). Germany is technically back in recession: many economists think that it is now in its third consecutive quarter of shrinking GDP.



Indeed, a study by HSBC finds that, although Britain's growth rate and output gap have converged with

the euro zone in recent years, Germany's economy has diverged from other members. This suggests that Germany may be worse suited than Britain to live with a one-size-fits-all monetary policy. Since Germany has the biggest output gap within the euro area, it needs lower interest rates than its fellows. Instead, Germany has the highest real interest rates, because it has the lowest inflation rate. This, in turn, further depresses growth. Moreover, Germany's lower inflation rate is not just cyclical. Differences in productivity and price levels within the euro zone mean that inflation is structurally lower in Germany. This implies that real interest rates may be permanently too high.

The second test asks whether the economy is sufficiently flexible to deal with “asymmetric shocks”, changes in the economic environment that affect some countries more than others. Flexibility matters because members of the euro zone cannot adjust national exchange rates or interest rates to cushion their economies, and fiscal policy is also constrained. Again, the answer is No. Look, for example, at Germany's struggle to cope with the effects of reunification. For all the recent talk of reform, the labour market remains sclerotic. Levies on wages to finance social security, health care and pensions are painfully high. There are strict laws controlling the firing of workers, and wages are rigid.

Test three is: will the euro encourage companies, especially foreign ones, to invest, by eliminating exchange-rate risk within the zone? If Germany's economy remains weak, it should surely fail this test too, because firms will be wary of expansion. Mr Brown's fourth test, the impact of the euro on the financial-services industry, may be less important in Germany than in Britain. However, foreign banks have slimmed down in Frankfurt, even though the city is home to the European Central Bank.

A failing economy

The fifth test is whether the euro will boost growth and jobs. Over the past couple of years, unemployment has increased by far more in Germany than in the rest of the euro area. Worse still, a recent study by the IMF warns that the country faces a serious risk of deflation, which could further depress output and jobs. Inflation is running at only 0.7% (well below the euro-area average of 1.9%), and increasing excess capacity and a stronger euro will push it lower still.

Deflation would be dangerous in Germany, given firms' heavy burden of debt and the fragile state of the financial system. Bank credit has already ground to a halt. Yet Germany cannot cut interest rates, because these are set by the ECB according to economic conditions across the whole euro area. Europe's stability and growth pact is forcing the German government to tighten fiscal policy too. Ironically, the rules for both the ECB and the stability pact were designed largely by Germany.

The IMF argues that monetary policy can prevent deflation, if it is pre-emptive and forceful. Those are not words that describe the ECB. At his May press conference, Wim Duisenberg, the bank's president, said: “In the 16 years that I was the governor of the central bank of the Netherlands, there were two years in which we had deflation of ½%. I publicly declared then that I lived in a central bankers' paradise.”

Whatever the economic arguments for Britain's joining the euro, the case for Germany's quitting looks stronger. The idea that Germany will do it is, of course, the stuff of fairy tales. However, the country's present predicament also has a fairy-tale feel, with the ECB in the role of the wicked witch who lured Hansel and Gretel into her gingerbread home with the aim of eating them. In the story by the Brothers Grimm, Gretel pushes the witch into the oven. In the real world, Germany is being roasted, and risks living unhappily ever after.

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Fetal origins of adult disease

The child is father to the patient

Jun 12th 2003 | BRIGHTON
From The Economist print edition

Many diseases of maturity have their origins at the start of life

BEGINNINGS are such delicate times. So much can go irreparably awry. About 15 years ago, David Barker, of Southampton University, in England, wondered if some adult diseases had their roots at the beginning of life, in developmental “decisions” taken by fetuses. Sometimes these decisions might be forced on a fetus by less than ideal circumstances. Sometimes they would be guesses about the future that turned out to be wrong. But the result in all cases would be misery in later life.

Dr Barker's idea has spread. It is now the subject of investigation by researchers all over the world, many of whom have just spent four days in Brighton discussing it at the second conference on fetal origins of adult disease. Heart disease, obesity and late-onset diabetes frequently seem to trace their origins back to conditions in the womb, or in the first few weeks of infancy. So do cognitive ability, earning power, and even greed and sloth.

This is a new take on biological determinism. It is not an individual's genes that are predisposing his fate, but his uterine environment. Or, at least, it is some combination of the two. For, as is so often forgotten in all the arguments about nature and nurture, environments can be just as prescriptive as genes.

The implications, notably for social and public-health policy, tend to reinforce the case for some measures that should be taken already. But there are surprises. Certain “obvious” remedies turn out to be worse than no action. That reveals a dilemma. Is it better to act now with what common sense suggests is right—or to wait a decade or more for scientific confirmation (or disproof) of a possible policy?

Making the best of things

Dr Barker's initial observation, based on several thousand people born in Hertfordshire before the second world war, was that babies who are particularly small grow into adults with a high risk of heart disease. Since then, low birth-weight has been associated with a collection of symptoms linked together in 1988 by Gerald Reaven of Stanford University, in California, and known as “syndrome X”. The features of this

syndrome are high blood pressure, disturbed fat metabolism and obesity. These, in turn, are indicators of somebody who is likely to develop heart disease and late-onset diabetes (which also turned up in the Hertfordshire study).

That small, food-deprived fetuses give rise to unhealthy adults is not exactly a surprise. What is surprising, though, is Dr Barker's idea that the pattern of their disease might be shaped by natural selection—in other words that it is programmed into a developing fetus.

There are two prongs to this hypothesis. The first is that a fetus has to cut its coat according to its cloth. Faced with a limited amount of food, it has choices about how to use it. Dr Barker's suggestion is that food will be allocated in ways that give an individual the best chance in early life, at the expense of later years when he will have had children and might, indeed, have died of something else. Above all, the growth of the brain is protected.

The second prong is that a fetus takes its cue about what it will eat after it is weaned from its mother's physiology, and adapts accordingly. In this case, disease is caused when the prediction is wrong. In particular, individuals adapted for a low-calorie, low-fat environment who find themselves, through improved circumstances, in a high-calorie, high-fat environment, might be expected to have problems.

There is evidence for both prongs. The idea that the brain is protected is supported by work carried out on rats by Susan Ozanne at Cambridge University. Dr Ozanne and her colleagues fed a group of pregnant rats a normal diet, and another group a restricted diet. They then measured the sizes of the brains, pancreases and muscles of the pups that were born. The pancreases and muscles of the pups born to restricted-diet mothers were much smaller than those of pups born to mothers on normal diets. Their brains were smaller, too—but only a little. And compared with body size, those brains were actually proportionately larger than those of pups born to well-fed mothers.

This appears to happen in people, as well. Towards the end of the second world war, the Netherlands was gripped by a famine known as the Dutch hunger winter. Men who were born just after this famine had abnormally large heads compared with their body weights.

There is also evidence that developmental compromises made by a fetus are, indeed, designed to put off the evil day when their consequences must be faced. For example, the high blood pressure associated with syndrome X stems, at least in part, from the way the kidneys develop. According to Barry Brenner, of Brigham and Women's Hospital, in Boston, Massachusetts, the kidneys of growth-restricted fetuses have fewer nephrons (the urine-forming elements) than those of normal fetuses. This saves resources, but means that each nephron has to work harder, which in turn means that they wear out and die faster. The result is yet fewer nephrons, so that each has to work harder still. And so on. Nephrons control blood pressure, so the result is hypertension. But it does not happen immediately. A study of conscripts in Sweden showed that at the age of 20, birth-weight has no effect on blood pressure. But after the age of 50, the effect appears and then grows ever larger.

Both these results suggest that fetuses do, indeed, cut their coat according to their cloth. And there is also evidence that they try to anticipate bad times—often with disastrous consequences.

Dr Barker's idea is that a fetus faced with a lack of nutrients develops thrifty habits. Developmental pathways are controlled by genes, but those genes are subject to regulation. Exactly what changes in genetic regulation are involved in the programming of thrift are unclear, although a few of the genes involved have been identified. However, the result, according to Dr Barker, is twofold. First, the fetus's tissues become more resistant to insulin—a molecule that opens the door for glucose to enter cells so that it can be burned to release energy, or used as a feed-stock to make other molecules. Second, the fetus becomes better able to lay down fat deposits in later life.

The insulin resistance, according to this idea, diverts glucose to the brain by keeping it available in the bloodstream. Insulin resistance stops muscles and other organs taking glucose up, but the brain (uniquely) does not need insulin to help it to absorb this sugar. Once programmed in, though, insulin resistance cannot be programmed out again. Too much insulin resistance causes blood-sugar levels to rise dangerously. In other words, it causes diabetes. (This is a different form of the disease from the one caused by lack of insulin.)

The advantage of laying down fat when food is plentiful is more obvious. It helps mature animals to get through lean times. Peter Gluckman, of the University of Auckland, in New Zealand, even goes so far as to describe the human “beer” belly as the equivalent of a camel's hump. These days, however, there are

no lean times. Diets are calorie-rich, and getting more so. As a result, both mechanisms are going horribly wrong. Even in the West, people conceived a decade or two ago are eating far more sugar and fat than their mothers did. The shift is greater still in many poor and middle-income countries. The result is epidemics of obesity, diabetes (due to too much blood sugar) and heart disease (due to high blood pressure and disturbed fat metabolism associated with changes in the body's fat-storing cells).

Mark Vickers, also from Auckland (a university that clearly knows the value of a good turn of phrase), has a catchier name than syndrome X for the phenomenon. He calls it couch-potato syndrome. That is because he has identified two other symptoms: greed and sloth. In rats, Dr Vickers's favoured experimental animals, low birth-weight pups from food-deprived mothers both eat more and are less active than those of normal weight from well-fed dams. There is every reason to believe that the same holds true for people.

This makes good sense. If the uterine environment suggests food is scarce, developing behaviour that both consumes as much as possible and conserves energy is wise. But combine it with a remote control, a bucket of fried chicken and a six-pack of beer, and the result will be that you put on not a hump, but a mountain.

No head start

Although Dr Ozanne's work suggests that the developing fetus does its best to protect its brain, that is not always enough. Johan Eriksson, of the National Public Health Institute in Helsinki, studied a group of Finnish men born in 1940. Their size as infants (admittedly measured when they were a year old, rather than at birth) was a disturbingly good predictor of their incomes 50 years later. Those 72cm long at that age had an average income of $27,000. Those 78cm long had an income of $39,000. The assumption—backed up by the men's school records when they were boys—is that this disparity is caused by differences in cognitive ability which are, in turn, the result of variations in early growth.

Body size is a relatively crude measure. Alan Lucas, of University College, London, reported a result that was even more disturbing. Like Dr Eriksson's work, Dr Lucas's study was not of children still in the womb. But, in a sense, they should have been, for they were all born prematurely. Dr Lucas looked at the effects of feeding such premature babies with a nutritionally enhanced “baby formula”. He compared their development with that of similar babies fed standard formula. The experiment lasted for a month immediately after birth. Then all the children went on to standard formula.

The children—1,000 of them—were born almost two decades ago, so they have now grown up. They were tested at the age of seven, and again in their mid-teens. The boys who had had only standard-formula milk had noticeably lower IQs than the others. They were particularly bad at mathematics. At the time of the second test, several of them were also put in a brain scanner. A small area of their left parietal lobes was less active than expected. The left parietal lobe is known to be involved in doing mathematical calculations. This result suggests an obvious intervention: do not feed premature babies on standard-formula milk. Perhaps other dietary interventions might help, too.

Eat up your greens

At first sight, the results look encouraging. Penelope Nestel of the Micronutrient Global Leadership Project, in Washington, DC, showed that giving expectant mothers in poor countries a balanced dietary supplement of protein, carbohydrate and fat helped to boost the birth-weights of their babies. Caroline Fall, one of Dr Barker's colleagues at Southampton, got similar results in India by encouraging expectant women to eat green vegetables in order to obtain micronutrients such as vitamins and minerals.

But one has to be careful. Dr Nestel showed that diets which supplemented only proteins actually stunted fetal growth. Nor did pure micronutrient supplements have any effect on birth-weight when she gave them to pregnant women. Policies based on these “obvious” interventions would be, respectively, damaging and uselessly expensive.

For those already born, however, the secret is to overcome couch-potato syndrome—eat less and exercise more. Exercise, in particular, is important, according to Christopher Byrne, who also works at Southampton. Even if you do not lose weight, it oxidises fats. That improves sensitivity to insulin. And that reduces the risk of diabetes. Dr Byrne can watch the biochemical changes happening at the level of

the messenger molecules that carry instructions from genes to the rest of the cell. Or you can watch it yourself in your increased chance of enjoying a healthy old age, regardless of your weight when you came out of your mother's womb.

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Blood transfusion

Cleaning up

Jun 12th 2003 | BETHESDA, MARYLAND
From The Economist print edition

Dangerous and mysterious microbes lurk in transfused blood. New blood-cleaning technologies could make them a thing of the past

IN A neglected corner of a lecture theatre at the National Institutes of Health, in Bethesda, Maryland, sits a glass cabinet containing a contraption that could have been created by Rube Goldberg himself. The Van Slyke manometric apparatus, with its rubber hosing, glass tubes and valves, was first used in 1921. It allowed scientists to analyse human blood.

Eight decades later, the analysis is still not complete. The precise constituents of blood remain a mystery, according to delegates gathered at an international symposium on transfusion safety held last week in that very lecture theatre.

This matters because, only last year, 23 Americans were infected with West Nile virus after blood transfusions. Six of them died. Before then, it had been thought that the virus could be transmitted to people only by infected mosquitoes. David Leiby, head of parasitology at the American Red Cross, says the virus “caught us off guard”.

This summer, when West Nile virus reappears, and continues its westward advance across America, the transfusion services will be ready. On July 1st, a new and exquisitely sensitive test for the virus's genetic material will be used to screen all blood donations. “Nucleic-acid amplification” works by the repeated replication of tiny amounts of the virus's genetic material, making it easier to detect.

Should this have happened sooner? No doubt the family and friends of the six people who died would say so. But with thousands of pathogens out there, and, according to Dr Leiby, new ones emerging almost every year, it is hard to know which are transmitted through blood. In the United States alone, about 14m units of blood are donated every year. It is impossible to test each unit for every known pathogen. And even though blood is routinely tested for agents that are known to be transmitted in it, such as HIV and hepatitis C, a “window period” remains when donors are infectious but blood tests will not detect the viral agents.

Blood simple

John Chapman, vice-president of research at Vitex, a firm based in Watertown, Massachusetts, thinks his company may have a solution to microbe-contaminated blood. The firm's pathogen-reduction system can inactivate blood-borne viruses and bacteria, as well as more complex parasites such as the one that causes malaria.

After blood has been given by a donor, its red cells are normally separated from the plasma. Pathogen-reduction techniques for plasma are already routine, but until now the red cells could not be cleaned up easily. Vitex's technique works by mixing them with a solution containing an anti-microbial molecule that belongs to a family of chemicals known as ethyleneimines. This molecule, which the firm calls Inactine PEN110, is strongly attracted to the chemical bases that make up DNA and RNA (the molecules that form the genetic material). The Inactine attaches itself to the DNA and RNA and stops these molecules being copied. Thereafter, microbes in the blood cannot reproduce and are killed. Red blood cells, which contain no DNA or RNA, are unharmed by this procedure.

The final stage in the process is to wash and spin the red cells to purify them. This step removes proteins and cellular debris in the blood. These cause allergic or immune reactions in about one person in a hundred. One substance removed is prion protein, the cause of CJD. Although it has not been proved that

blood-borne prions can infect people, their presence worries those who run blood-transfusion services.

Dr Chapman argues that removing all microbes, whether or not they are known to cause harm, is a key advantage of his technology. By contrast, testing for pathogens deals only with cases as they become apparent in transfusion patients.

That could be significant. Michael Busch, vice-president of research at Blood Centres of the Pacific, a transfusion service, says that many diseases, such as some cancers and auto-immune disorders, are suspected of having an infectious origin. Some 15% of cancers may have a viral trigger. Are these transmitted via blood? Nobody knows.

Nor is it always clear whether a virus is dangerous. Hepatitis G, a recently discovered virus that has no known associations with disease, is found in 1-2% of donors. At the moment it is not removed. But, as its name suggests, it is related to viruses that do cause disease, so maybe it should be.

Earlier this year, Vitex began phase-three trials (the last stage before applying for regulatory approval) to evaluate the safety and efficacy of its treatment. Even if the trials are successful, it will take until 2005 before the company wins that approval. Vitex will have to demonstrate that its treatment does not harm red blood cells, and that its chemical agent is harmless to the recipients of donations. And Vitex is not the only company chasing pathogen reduction. Cerus, of Concord, California, is also involved in phase-three trials of a technology that prevents DNA and RNA replication in blood.

Complex decisions

At present, pathogen reduction is controversial among transfusion experts. Although many believe that, once it is proved safe, its introduction will be inevitable, they fret that it will introduce yet another layer of expense to cash-strapped transfusion services. Some fear that the new technology could cost as much as $100 per unit of blood. Vitex argues that pathogen reduction would eliminate the need for expensive viral tests of donated blood, saving transfusion services another big expense. But transfusion experts counter that it would be hard to persuade the public to accept an end to blood tests. That is why America still tests blood for syphilis, even though it is no longer a problem in transfused blood.

Testing for pathogens is also likely to improve over the next decade, with the introduction of devices capable of looking for a wide range of bugs at the same time. But, as researchers find out more about the multitude of viruses and bacteria that live in human blood, and thus discover new things to worry about, it is likely that the idea of removing microbes completely will gain appeal in increasingly risk-averse rich countries. It is possible, then, that both pathogen reduction and testing will operate simultaneously.

Poorer countries are unlikely to face the dilemma of whether to use pathogen reduction in red blood cells any time soon, because they will not be able to afford it. In Europe, Japan and the United States, though, Vitex estimate that over 40m units of red cells are transfused annually, offering a “$4 billion market opportunity”. If pathogen reduction is approved, those involved will have struck a rich vein.

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About sponsorship

Wagner in Russia

Ringing in the century

Jun 12th 2003 | ST PETERSBURG
From The Economist print edition

Lebrecht

After a gap of nearly 100 years, the Russians are staging Wagner's "Ring"

WITH its towering gods, its wilful women, its epic struggles and its 2,000 pages of musical score—the equivalent of 20 symphonic concerts played over just four nights—Wagner's "Ring" cycle is a challenge for any conductor. "When you step on to the rostrum for 'Das Rheingold'," Sir Georg Solti said some 20 years ago, "you look at your hand, knowing that it will not stop for two-and-a-half hours. You wonder: Can I sustain it? What shape will I be in? Will I want to go to the toilet?" For Valery Gergiev, the fiery angel of the Mariinsky Theatre, who conducts the complete "Der Ring des Nibelungen" in St Petersburg this month, there is the added pressure of history. Mr Gergiev's "Ring" will be the first Russian production since before the first world war.

Russians had long been opera enthusiasts when, in 1783—the year the Bolshoi was founded opposite the Mariinsky, on the site occupied today by the St Peters-burg Conservatory—Catherine the Great ordered that theatres should not be "merely for comedies and tragedies, but also for operas". And although they were slow to succumb to the Wagner mania that gripped almost every European capital in the second half of the 19th century, they made up for it soon enough.

Wagner chose the city for the first performance of the Prelude and Liebestod of "Tristan und Isolde", and in 1907 St Petersburg was host to his "Ring", which had already impressed audiences in London and New York, as well as Bayreuth, Wagner's musical and spiritual home. Several repeat performances had to be put on through the year to satisfy the Petersburg *beau monde*. The German-born Empress Alexandra ensured that Wagner's work remained fashionable in Russia, and in 1913 the clamour for tickets for a performance of the "Ring" in Moscow was such that mounted police had to be called in to keep order at the box office.

By the time the Romanovs were on their way out and German music had been banned in Russia with the start of the first world war, there were eight works by Wagner in the repertoire at the Mariinsky, a quarter of its total. Fyodor Chaliapin, the Russian bass whose huge voice and commanding presence embodied Wagner's vision of opera as *Gesamtkunstwerk* (a complete work of art), had become one of the composer's most enthusiastic followers.

In his youth Wagner had written several forceful political tracts, such as "Art and Revolution" and "The Art-Work of the Future", which advocated the abolition of all class-ridden cultural institutions. For a time he was friendly with Mikhail Bakunin, the anarchist. The tsarist secret police thought it wise to put the composer under surveillance when he visited Russia in 1863, even though he had by that stage renounced revolution and was far more interested in penetrating the imperial court in the hope of finding

a rich patron.

Although Wagner would eventually enjoy royal backing, after King Ludwig II of Bavaria became his patron in 1864, his music was widely regarded as revolutionary. In the early 20th century many liberal-minded young Russians saw the “Ring” as a political allegory, viewing the all-enveloping flames that finally swallow Valhalla as prophetic of events in Russia, and the young Siegfried as the ideal prototype of the revolutionary hero.

The vision of art for the people that Wagner had expressed so fearlessly in his youthful revolutionary writing was adopted as a blueprint for Soviet culture in the same way that the Communist manifesto provided a model for Soviet society. Lenin nurtured a particular passion for Wagner: Siegfried's funeral march was played at the memorial concert after his death in 1924.

A Wagnerian enemy

All that changed, of course, with Stalin's cultural revolution, when militant communist ideology began to dictate every sphere of Russian life. Hitler himself was a keen Wagnerian, which led the authorities to expunge virtually all the German composer's work from Russian repertoires. An exception was made for “Die Walküre”, which Sergei Eisenstein staged at the Bolshoi in 1940 as a pro-German gesture after the signing of the ill-fated Molotov-Ribbentrop pact.

For half a century after that, “Lohengrin” would be the only Wagner opera in the Mariinsky's repertoire, though it was always sung in Russian. Mr Gergiev, who took over as artistic director of the theatre shortly after the fall of communism in 1989, is very much the non-traditionalist as far as Wagner is concerned, both politically and musically—he has a light touch with the baton that highlights his indebtedness to Weber and Beethoven—and he has been keen to reintroduce the real Wagner to the Russian repertoire. “I love Wagner from the bottom of my heart,” he told *The Economist* four years ago. “All I want is for Russians to be able to hear his music, in German, in their own theatres. That is my ambition.”

But singing in German is very difficult for Russian voices, and Wagner more so than most. After a musical silence of almost 50 years, Mr Gergiev's company had no obvious candidates for Brünnhilde or Siegfried. They would have to train them from scratch. The three Russian stars of the forthcoming “Ring” have come up through the Mariinsky's rigorous voice school.

Vladimir Vaneyev, who sang a magnificent Boris Godunov at La Scala in Milan last year, has had his eye on singing Wotan for some time. Viktor Chernomortsev, who will take the part of Alberich under Mr Gergiev's baton, is another singer who has put himself through the training required to sing Wagner, while the young Olga Sergeyeva has been working on Brünnhilde ever since she first sang the part at Baden-Baden two years ago.

While the singers have been perfecting their German, Vladimir Mirzoyev, the director, has sought a particularly Russian meaning in Wagner's masterpiece about a golden ring from the bed of the Rhine and the gods who reject love in the pursuit of the power of the ring, leading inevitably to conflict and the collapse of the existing order. “Russia”, says Mr Mirzoyev, “must lay aside its blood-spattered beginnings. That, for me, is the reason this ‘Ring' has appeared at this particular moment.” Wagner, who believed his work to have a universal appeal, would be delighted to know he is still so deeply needed.

The complete “Ring” cycle by Richard Wagner is being performed at the Mariinsky Theatre, St Petersburg, from June 13th-18th, as part of the White Nights Festival. Details from www.mariinsky.ru

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Thailand's transvestites and transexuals

Skirting pain

Jun 12th 2003
From The Economist print edition

IT IS, one imagines, every sex-tourist's nightmare: the go-go bar, the tuk-tuk, the hotel room and then...the discovery that there is rather more to the lovely lady than had been bargained for. Thailand's ladyboys have struck again.

Richard Totman, a theatre director-cum-psychologist, has taken the trouble to get to know several *kathoey* over a period of years, and his book is a gentle and fascinating account of their lives. *Kathoey*, he maintains, genuinely are neither male nor female, but something in between that he calls a "third sex", though in truth his belief is that sex is really more of a continuum.

Their origins are traced far back in Buddhist, and even into animist, scripture, and there is a canter through some of the biology—but Mr Totman's studies do not reveal any genetic or biological difference between *kathoey* and normal males. Most of the *kathoey* he interviewed, however, say that they have felt like women trapped in men's bodies from an early age. Where Thailand differs from most countries in the West is that such people have historically been accepted in a way which Europeans generally would find impossible.

Inevitably, though, acceptance has its limits and *kathoey* have gravitated towards vice. Thailand does not permit them, even those who have opted for full sex-change surgery, to change their sex in the eyes of the law, or to marry men. Most of them, Mr Totman finds, are keen to avoid prostitution, but drift into it anyway, the alternatives for a man who lives as a woman being distinctly limited. This does not mean, though, that they are entirely unable to maintain what they crave, a relationship lived as a woman, though loneliness is, traditionally, a *kathoey*'s lot. In two of the three cases that Mr Totman examines in depth—the bulk of the book consists of these three life stories—the *kathoey* formed relationships with western men, who, though initially under the impression that they were with genuine women, accepted them once they realised their mistake.

The Third Sex: Kathoey, Thailand's Ladyboys.
By Richard Totman.
Souvenir Press; 181 pages; £16.99

The Third Sex: Kathoey, Thailand's Ladyboys
By Richard Totman

Souvenir Press; 181 pages; £16.99

Buy it at
Amazon.co.uk

Reuters

Nobody's perfect

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The Suez Canal

A cut in the dunes

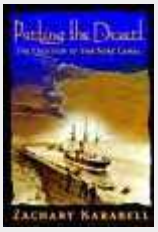
Jun 12th 2003
From The Economist print edition

WHO now recalls that Frédéric Auguste Bartholdi, creator of the Statue of Liberty, first tried to plant his luminous lady not in New York harbour, but at the homely entrance to the Suez Canal? In her original form, she was to be an Egyptian peasant swathed in robes, and titled “Egypt Bringing Light to Asia”.

The canal today is taken for granted, much like the Bosphorus or the Strait of Gibraltar. But as Zachary Karabell reminds us in this concise and pleasantly digressive history, the waterway's creation stirred great passions in the 19th century.

The Universal Company of the Maritime Suez Canal, formed in 1858, was one of earliest multinational corporations: its directors were French, Belgian, American, Russian and Venetian. It may be that broad trends, such as the triumph of notions of progress, the decline of the Ottoman empire, the advance of mechanisation and the emergence of international capital markets, made the construction of the canal inevitable. Yet the momentous events of the century also kept intruding, among them the European revolutions of 1848, the Crimean war, the Indian Mutiny and the American civil war, this last causing such a boom in cotton prices that Egypt's rulers binged the country into ruin.

Parting the Desert: The Creation of the Suez Canal
By Zachary Karabell



Knopf; 310 pages; $27.50.
John Murray; £25

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It is also a tale of colourful and clashing personalities. France's strutting emperor, Napoleon III, backed the canal while Britain's curmudgeonly prime minister, Lord Palmerston, did all he could to scupper it. Successive Egyptian viceroys went hot and cold, one day seduced by the glamorous notion of straddling world trade, the next fearing (correctly) that the canal would tempt Europe to devour them. But it was the canal's promoter, a French diplomat by the name of Ferdinand de Lesseps, who was the canal's most energetic midwife, tirelessly prodding, cajoling and lobbying the project to fruition.

Along with intrigue, there is also sex—though not of the bodily sort. The 19th-century European mind was consumed with titillating notions of eastern voluptuousness. France's then-guru of the cult of progress, Barthélemy-Prosper Enfantin, once described Egypt as the “nuptial bed” where the symbolic union between a supposedly “female” East and “male” West would be enacted. The very term Isthmus of Suez seemed to tingle, to an expanding Europe, like an erogenous zone.

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By Zachary Karabell
Knopf; 310 pages; $27.50.
John Murray; £25

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About sponsorship

Jean-Marie Messier

Himself

Jun 12th 2003 | PARIS
From The Economist print edition

Where did it all go wrong?

JEAN-MARIE MESSIER is the discredited former head of Vivendi Universal who, last year, came close to propelling the company to bankruptcy. Two new books offer competing explanations. The first, by the erstwhile mogul himself, argues that he was the victim of a French corporate cabal which went on a "man-hunt *à la française*" to evict him. The second, by two journalists, one at *Le Monde* and the other at the *Financial Times*, argues that he was the victim of his own reckless vanity and overweening self-belief.

Mr Messier, who built a Hollywood-to-mobile-phones conglomerate on the back of a French water and sewage utility, blames his downfall largely on external factors: rivalries within the French business elite and the bursting of the dotcom bubble. The man nicknamed J6M—Jean-Marie Messier, Moi-Même, Maître du Monde—does confess to mistakes. Among them, he acknowledges mishandling the company's debt, taking on too many short-term liabilities. He also regrets his "excessive media profile" and his taste for publicity: as the company's stock price was crumbling, he posed for *Paris-Match*, France's equivalent of *Hello*, ice-skating in Manhattan.

The underlying tone, though, is one of contempt: for the hedge funds, credit-rating agencies, journalists, analysts, members of his own board and, above all, for the French business establishment. Each, he claims, panicked in the face of the collapse of new-media stock prices, and the hysteria provoked by the scandals at Enron and WorldCom—and turned, unfairly, on him. It was nothing less than a "lynching", prompted by personal resentments, and with two chief culprits. One was *Le Monde*, which he claims never forgave him for not having sold it *L'Express*, a news magazine, back in 1998. The other was Claude Bébéar, chairman of AXA, the French insurance giant, and not then (though now) a Vivendi board member, whom he accuses of manipulation and destabilisation driven by a "fierce desire" to be seen as "the godfather of French capitalism". The man who took over at Vivendi, Jean-René Fourtou, was Mr Bébéar's vice-chairman at AXA.

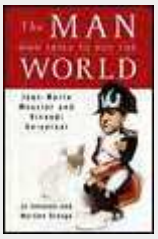
Mr Messier refused to speak to the authors of the second book: in his own pages, he names both as having been out to bring him down. Their version gives weight to the aspirant mogul's "dreams of grandeur" and "megalomania". Seduced by his initial success, he failed to guard against the possibility of things going wrong. He repeatedly overpaid for acquisitions, even after the internet boom had bust. In the end, he left the company with a massive *euro*19 billion debt, and, thanks to write-downs of the assets he had so hurriedly acquired, the biggest loss in French corporate history.

Mon vrai journal
By Jean-Marie Messier and Yves Messarovitch

Balland; 309 pages; euro19.50

Buy it at
Amazon.fr

Un faillite française
By Martine Orange and Jo Johnson



Albin Michel; 315 pages; euro19.50. To be published in Britain and America as "The Man Who Tried to Buy the World: Jean-Marie Messier and Vivendi Universal" by Viking in July and Portfolio in September

Buy it at
Amazon.com
Amazon.co.uk

A man seduced

According to Martine Orange and Jo Johnson, Mr Messier was seduced by the glamour of Hollywood and his own growing celebrity. Hollywood treats foreign investors, they say, according to a well-worn ritual: "dazzle them, get them to invest as much money as possible, and then drive them out as soon as they are broke." In a candid remark, Ron Meyer, head of Universal Studios—which the French mogul bought in

2000—says: “Did people really take Jean-Marie Messier seriously? No. But we're a cynical town where numerous people come and go...It takes time to establish credibility in Hollywood.”

A product of the traditional French educational and bureaucratic establishment, Mr Messier reinvented himself. He dieted, got a sun-tan, travelled about in private jets, posed for the cameras, lived in a swanky Park Avenue apartment and holidayed in the Bahamas. His diary was a whirlwind of Hollywood parties, dinners in Malibu and star-studded events. The French elite, for whom he had once been a symbol of the new, dynamic, internationally-minded French business culture, did not like it one bit. They frowned on him, then were embarrassed by him, then got rid of him.

The more serious allegation in this book is that Mr Messier repeatedly concealed from his board, and his managers, the complicated and precarious deals and transactions he was carrying out, not to mention the company's debt position, which ultimately brought Vivendi to the edge of collapse. In the end, he pursued his vision of a converged media company with a breathtaking financial recklessness. For this, the authors blame not only Mr Messier, but French corporate governance, whose tradition of intertwined directors and supine institutional shareholders enabled him to get away with it.

Mon vrai journal.
By Jean-Marie Messier with Yves Messarovitch.
Balland; 309 pages; euro19.50

Un faillite française.
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New American fiction

In over his head

Jun 12th 2003
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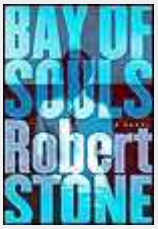
THIS plot feels tired. Regular guy, led by his genitals, samples the underworld, and becomes a little unhinged: “He wanted to share a taste of danger with her. To descend as far, to take as much of her as he could survive, and risk even more.”

The Caribbean setting, where a desultory coup is under way, is pro forma; occasionally a hard-bitten journalist, shady CIA operative, or shifty junta general provides perfunctory (if painfully familiar) atmosphere. The local voodoo folderol (drums, dancing, rites, etc) borders on comical, and constitutes a lazy, cookie-cutter shorthand for the horror, the horror. The lover's incessant iterations that some woman named Marinette “has custody of her soul” are increasingly irritating.

Moreover, the protagonists' extracurricular follies aren't persuasively erotic, but stiff, technical, and dependent on hackneyed leather props. Thus his collapse into deep, terrible badness feels so under motivated that when he arrives in St Trinity, Robert Stone's stand-in for Haiti, it is as if he got on the wrong plane by accident. Left cold by both the sex and the siren herself, who is such an artificial construct, the reader is left puzzling: why would he wanna do that?

Bay of Souls
By Robert Stone



Houghton Mifflin; 256 pages; $25. To be published in Britain by Picador in February 2004

Buy it at
Amazon.com
Amazon.co.uk

Mr Stone is a fine writer. “Dog Soldiers” (1974), for example, did a frighteningly credible job of portraying another naive American who bites off more menace than he can chew among ruthless sleazebags. The uninitiated might also dip into his riveting “A Flag for Sunrise” (1982) or “Outerbridge Reach” (1992). From such an accomplished novelist, though, “Bay of Souls” is quite a let-down.

Bay of Souls.
By Robert Stone.
Houghton Mifflin; 256 pages; $25. To be published in Britain by Picador in February 2004

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About sponsorship

George Orwell

The master's voice

Jun 12th 2003
From The Economist print edition

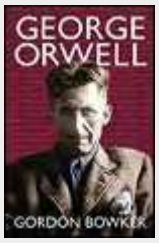
The English essayist and novelist still confounds his readers

AS ONE of the masters of English prose, George Orwell (1903-50) is a puzzling case. Contemporaries knew that he was special, but often found it hard to say why. Getting him into focus grows no easier with time. His best work was political, but his politics were difficult to pin down. Shy in person, though vehement on the page, he could fairly describe himself as simultaneously a left-wing socialist, an anti-communist and a Tory anarchist.

The puzzle is compounded by the variety and unevenness of Orwell's writing. He is best known for two anti-totalitarian parables, “Animal Farm” (1945) and “Nineteen Eighty-Four” (1949), which made him, just before his death, into one of the first truly global literary stars. Yet their immediate target, Soviet communism, has passed into history, and the second book in particular has acquired a dated feel.

The man himself strikes a notably old-fashioned figure—tall, gaunt, rather shabbily dressed, bent over a typewriter with permafag stuck to the lip. Yet confining Orwell to the austerity of the 1930s and 1940s is a mistake. Anyone who turns back to his finest essays or to his classic piece of war writing, “Homage to Catalonia”, will hear a voice that speaks as urgently to our times as it did to his.

George Orwell
By Gordon Bowker



Little, Brown; 495 pages; £20.

Buy it at Amazon.co.uk

Orwell: The Life
By D. J. Taylor

Chatto & Windus; 466 pages; £20.

Buy it at Amazon.co.uk

Locking people up

Orwell's life, ably recounted in these two new biographies, offers clues to the values he held and the nature of his achievement. He was born Eric Arthur Blair in Bengal, where his father worked in the office that regulated China's opium trade. Shipped back to England as a child, he trotted obediently off to prep school. Later he wrote of its miseries in “Such, Such Were the Joys”, a vivid recollection of homesickness, arbitrary rule and the oppressiveness of “team spirit”.

An underperforming scholar at Eton, he was just young enough to escape the slaughter of the first world war. Rather than follow school friends to Oxford or Cambridge, he signed up for the colonial police in Burma. The job turned him against colonialism—he was fed up, he wrote, with locking people up for doing what he would do in their shoes—and he soon left.

From this experience came two superb autobiographical stories, “Shooting an Elephant”, a self-critical piece about the disturbing power of crowds, and “A Hanging”, a quietly brilliant polemic against the death penalty.

Back in Europe, Orwell worked in Paris in a hotel kitchen, joined tramps in London doss-houses and visited unemployment-racked regions of Britain. The results were two highly personalised documentaries, “Down and Out in Paris and London” and “The Road to Wigan Pier”.

In 1936 he went to Barcelona to report on the Spanish civil war. Not content to watch, he enlisted with

the Republicans, though hostile to their Soviet backers, and almost died of a neck wound.

Spain was Orwell's defining moment and perhaps also the high point of his life. Though recognition followed, his remaining years were hard. Tubercular lungs kept him in continual ill health. In 1945, soon after he and his wife, Eileen, adopted a son, she died during an operation for uterine cancer. When serious money came in at last with “Animal Farm”, releasing Orwell from day jobs, he took the toddler and a housekeeper to live on the remote tip of the Scottish island of Jura.

The other side of Orwell's burning conscience was an almost monkish ability to cut himself off. His health grew worse, his lungs haemorrhaged and in January 1950 he died.

Gordon Bowker and D.J. Taylor wrote their books to coincide with Orwell's centenary on June 25th. Both are good, clear accounts of his life, though neither supersedes Bernard Crick's 1980 biography. They note Orwell's originality in writing seriously about popular culture, his essentially political view of literature and his philistine hostility to avant-garde art.

Mr Taylor focuses on the man more than the works, interleaving his chronology with brief themelets on, for example, Orwell's face, his voice, his preoccupation with rats, his alleged anti-Semitism and his paranoia. Though duly recording them, Mr Bowker is less quick to flog Orwell for his human and journalistic failings, which included a tendency to self-pity, a certain mercilessness towards women and an inventive looseness with facts. Orwell, who boiled with anger beneath a quiet exterior, was perfectly good at flogging himself. Mr Bowker is also surer at putting Orwell into his political and cultural context.

Early death

In particular, Mr Bowker reminds us of the striking parallels between Orwell and Albert Camus (1913-60), another tubercular writer preoccupied with the individual in mass society, who died—in a car smash—also at 47. Camus was the better novelist, but their moral vision was remarkably close. Personal engagement and behaving decently mattered more to them in politics than policy or dogma. Neither was happy in party camps. They were distrusted by right and left alike. Both recognised the violence that could result from bad thinking and bad writing—a lesson Orwell put memorably into “Politics and the English Language”. Both believed in the boundlessness of our duty to resist injustice, yet took a bleakly limited view of how far any of us could succeed. Orwell, who was allergic to theory and speculation of all kinds, would have hated the word, but in a sense he was England's existentialist.

Preachy Orwell certainly was. But his anti-authoritarian sermons could almost always make you laugh. He was a master of the one-liner: “Good prose is like a window pane”; “At 50, everyone has the face he deserves.” Whether his weekly column was on writing clearly, resisting tyranny or making tea, he always made it sound like a matter of life and death. Newspapers nowadays tend to have more columns than a Roman temple, all interchangeable and most of them redundant. Few, if any, have Orwell's indispensable voice.

George Orwell.
By Gordon Bowker.
Little, Brown; 495 pages; £20.
To be published in America as “Inside George Orwell: A Biography” by Palgrave Macmillan in September

Orwell: The Life.
By D. J. Taylor.
Chatto & Windus; 466 pages; £20.
To be published in America by Henry Holt in September

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About sponsorship

Felix de Weldon

Jun 12th 2003
From The Economist print edition

AP

Felix de Weldon, sculptor of the monumental, died on June 3rd, aged 96

STROLLING around Washington, DC, you get the impression that the capital is anxious to impress visitors with its sense of American history. No sooner is a president dead than a statue, of a suitably statesmanlike appearance, will pop up in a public place. The country's military endeavours are marked by memorials of panoramic extravagance. During the past 50 years or so, many such sentinels have been the work of Felix de Weldon. His most famous piece, and one that attracts many thousands of admirers each year, is of marines raising the Stars and Stripes on Iwo Jima in the second world war.

The battle for Iwo Jima was a particularly bloody one, even by the wasteful standards of the Pacific conflict. Some 6,800 Americans and 20,000 Japanese died in the fight for the tiny island. During the battle the nearly exhausted Americans were heartened by the sight of their flag suddenly appearing on a mountain top in the centre of the island. A photograph taken of six men struggling to raise the flag was published throughout the world. Mr de Weldon's sculpture, based on the photograph, became one of the best-known memorials to valour.

Some sceptics have suggested that the photograph was faked. Photographers know that “spontaneity” may often require planning. A much reproduced photo by Robert Capa of a fighter shot in the Spanish civil war in 1936 may have been staged. A scene of General Douglas MacArthur paddling ashore to retake the Philippines in 1944 (also turned into a sculpture) was re-enacted for photographers several times. On the morning of February 23rd 1945 in Iwo Jima a flag was raised on the mountain top but it came down. Later that day, when the fighting had eased, a larger flag was raised, and the event was photographed by Joe Rosenthal, of the Associated Press agency. His picture, later cropped, was the one that became famous. The American government, which used the patriotic icon as part of a campaign to sell bonds, said the flag was raised under fire, regarded as a forgivable white lie at time of war.

The Kennedy portrait

What particularly pleased Mr de Weldon's clients was that he was a traditionalist. When Jacqueline Kennedy wanted a portrait bust of her murdered husband, Mr de Weldon was her immediate choice. He provided an exact image. “When she saw the finished work for the first time,” Mr de Walden recalled,

“she burst into tears.” Verisimilitude was in his gift. It is evident in the 1,200 sculptures, large and small, he created in, as he proudly noted, seven continents. (A de Weldon monument of Richard Byrd, an American polar explorer, is in McMurdo Sound, in Antarctica).

He seems to have been a natural craftsman and his skills were quickly recognised at art school in Vienna, where he was born. Had he stayed in Austria, he would have found it difficult to scrape a living as an artist, and was disinclined to join the family firm of textile manufacturers. Austria in the 1920s was a dispiriting place for a young person. As a result of the first world war it had been reduced to a small, impoverished country that was later to be absorbed by Hitler's Germany. Mr de Weldon wandered around Europe, joining artists' colonies in France, Italy and Spain and eventually living for a time in London, where he gained a number of commissions, among them a portrait sculpture of George V.

This led to a trip to Canada to sculpt its prime minister, Mackenzie King. But Mr de Weldon decided, like many Europeans before him, that the United States was where he wanted to settle. He became an American citizen, served in the navy during the war and was made an official naval artist. When he saw Joe Rosenthal's picture of the flag-raising in Iwo Jima he made a plaster model of the scene. This was the icon the government used to sell war bonds, and which led to Mr de Weldon being given the commission by Congress to make the Washington sculpture.

A less traditionalist sculptor, such as Henry Moore or Barbara Hepworth, might have produced a more impressionistic piece. But Congress wanted realism, something that would be readily recognisable by ordinary Americans and not need “explaining”. Mr de Weldon obliged. The piece is extraordinarily detailed. He made sculptures from life of three of the six men raising the flag. The other three, who had died in action later, were sculpted from photographs. Mr de Weldon took nine years to make the memorial, helped by hundreds of assistants.

As a symbol of patriotism, the 100-tonne bronze is a triumph. Some critics, while admiring its craftsmanship, compare it to triumphalist monuments once favoured by European countries when they had empires, and which proliferated in the Soviet Union. They pointed to Mr de Weldon's other monumental works, among them his “space tribute”, a statue of an unusually muscular man hurling a Saturn rocket into orbit. Mr de Weldon was unperturbed by such observations. He could point to respected authorities who said he was America's greatest sculptor of the 20th century; and that the country was fortunate in having an artist who could express national feeling so well. You could not argue with that.

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Overview

Jun 12th 2003
From The Economist print edition

American unemployment rose in May to 6.1%, the highest in nine years; non-farm payroll employment fell by 17,000. Most of the decline was in manufacturing, where 2.6m jobs have been lost since July 2000. Unemployment also rose in **Canada** in May, for the second consecutive month.

The outlook remains gloomy for the **euro area**, in spite of the European Central Bank's latest interest-rate cut. **German** industrial production fell by 1% in April. Europe's largest economy is already technically in recession.

The **Japanese economy**, however, showed modest signs of revival. Revised figures for GDP in the first quarter show that it grew at an annual rate of 0.6%, rather than stagnating as first thought. And both narrow- and broad-money growth accelerated in May. The current-account surplus widened by 2% in April, to $111.7 billion.

In **Britain**, the labour market, which has been remarkably resilient through the recent slowdown, showed signs of weakness. The number of people unemployed and claiming benefit rose in May by 9,700, the biggest increase since December 1992. Jobs in manufacturing continued to fall, reaching their lowest level in almost 20 years. The annual rate of headline earnings growth dipped from 3.4% to 3.2%.

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Output, demand and jobs

Jun 12th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.9	Q1	+ 2.8	+ 3.0	+ 3.6	+ 2.3	Q4	+ 4.0	Q1	6.0	May	6.2
Austria	+ 1.3	Q4	– 0.5	+ 0.9	+ 1.6	– 1.5	Dec	+ 0.9	Dec	4.3	May	4.1
Belgium	+ 1.3	Q1	+ 0.6	+ 1.0	+ 2.0	+ 1.6	Apr	– 1.7	Mar	11.4	May†	10.4
Britain	+ 2.2	Q1	+ 0.3	+ 1.8	+ 2.5	– 1.8	Apr	+ 2.7	Apr	5.1	Apr††	5.2
Canada	+ 2.6	Q1	+ 2.4	+ 2.6	+ 3.1	+ 2.0	Mar	+ 2.3	Mar	7.8	May	7.7
Denmark	+ 1.2	Q1	+ 1.4	+ 1.4	+ 2.2	– 0.2	Apr	– 1.6	Apr	5.8	Apr	5.0
France	+ 1.0	Q1	+ 1.0	+ 1.0	+ 2.2	– 0.5	Apr	+ 2.1	Apr	9.3	Apr	8.9
Germany	+ 0.2	Q1	– 0.9	+ 0.2	+ 1.4	– 0.3	Apr	+ 0.8	Apr	10.7	May§	9.7
Italy	+ 0.8	Q1	– 0.4	+ 0.9	+ 1.9	– 0.7	Mar	– 1.6	Mar†	9.0	Jan	9.0
Japan	+ 2.6	Q1	+ 0.6	+ 0.9	+ 0.9	+ 3.4	Apr	– 2.7	Apr	5.4	Apr	5.3
Netherlands	– 0.1	Q1	– 1.2	+ 0.2	+ 1.7	– 0.8	Apr	– 2.5	Dec	5.3	Apr**	3.9
Spain	+ 2.1	Q1	+ 2.0	+ 2.0	+ 2.7	– 4.2	Apr	+ 1.3	Mar	11.4	Apr	11.2
Sweden	+ 2.2	Q1	+ 2.4	+ 1.4	+ 2.3	– 3.9	Mar	+ 4.9	Apr	4.6	Apr†	3.8
Switzerland	nil	Q1	– 1.0	+ 0.7	+ 1.7	– 2.1	Q4	– 3.1	Feb	3.6	May†‡	na
United States	+ 2.1	Q1	+ 1.9	+ 2.2	+ 3.3	– 0.4	Apr	+ 4.9	Apr	6.1	May	5.8
Euro area	+ 0.8	Q1	nil	+ 0.8	+ 2.0	– 0.3	Mar	– 1.6	Mar	8.8	Apr	8.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.2	Q1	– 4.9	na	na	– 2.3	Apr	+ 4.9	Feb	10.4	Apr†	10.4
Greece	+ 4.3	Q1	na	na	na	– 0.1	Apr	na		na		na
Iceland	– 3.0	Q4	na	na	na	– 0.3	2002	na		3.9	Apr†	2.6
Ireland	+ 6.4	Q4	na	na	na	– 5.6	Mar	+ 1.7	Mar	4.6	May	4.3
Luxembourg	+ 1.1	2002	na	na	na	– 2.1	Feb	+ 4.6	Jan	3.6	Apr	2.7
New Zealand	+ 4.2	Q4	+ 2.0	na	na	+ 5.9	Q4	+ 6.4	Q1	5.0	Q1	5.3
Norway	+ 0.6	Q1	+ 1.3	na	na	–13.6	Apr	+ 4.5	Apr	4.4	Q1	4.1
Portugal	– 1.2	Q1	+ 0.3	na	na	– 3.1	Apr	+ 2.4	Apr	6.4	Q1†	4.5

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 3.1% in May. §EU harmonised rate 9.4% in May. **Feb-Apr.

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Prices and wages

Jun 12th 2003
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2003	The Economist poll consumer prices forecast 2004	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.7	+ 2.5	+ 3.0	Q1	+ 0.5	+ 4.3	Q1	+ 4.1
Austria	+ 1.3	Apr	+ 1.8	+ 1.5	+ 1.3	+ 0.6	May	– 0.8	+ 2.2	Apr	+ 2.4
Belgium	+ 1.0	May	+ 1.3	+ 1.4	+ 1.3	+ 0.2	Apr	– 0.2	+ 2.4	Q1	+ 3.1
Britain	+ 3.1	Apr	+ 1.5	+ 2.8	+ 2.4	+ 1.3	May	+ 0.1	+ 3.2	Apr	+ 3.3
Canada	+ 3.0	Apr	+ 1.7	+ 3.1	+ 2.1	– 0.1	Apr	– 1.1	+ 1.6	Mar	+ 3.2
Denmark	+ 2.2	May	+ 2.1	+ 2.4	+ 1.9	– 0.5	Apr	+ 0.3	+ 3.9	Q4	+ 4.1
France	+ 2.0	Apr	+ 2.0	+ 1.8	+ 1.4	+ 1.0	Apr	– 0.6	+ 2.9	Q1	+ 4.0
Germany	+ 0.7	May	+ 1.2	+ 1.0	+ 0.9	– 0.2	May	– 1.3	+ 3.7	Mar	+ 2.6
Italy	+ 2.7	May	+ 2.3	+ 2.4	+ 1.9	+ 2.0	Apr	– 0.8	+ 1.7	Apr*	+ 2.3
Japan	– 0.1	Apr	– 1.1	– 0.5	– 0.5	– 0.8	Apr	– 2.3	+ 1.9	Apr	+ 0.4
Netherlands	+ 2.3	May	+ 3.3	+ 2.5	+ 2.1	+ 2.5	Apr	– 1.0	+ 2.7	Apr	+ 3.9
Spain	+ 2.7	May	+ 3.6	+ 3.0	+ 2.6	+ 1.4	Apr	+ 0.5	+ 3.9	Q4	+ 3.7
Sweden	+ 2.3	Apr	+ 2.5	+ 2.4	+ 1.8	– 0.1	Apr	– 0.7	+ 0.9	Mar	+ 4.7
Switzerland	+ 0.4	May	+ 0.6	+ 0.7	+ 0.9	– 0.3	Apr	– 1.4	+ 1.8	2002	+ 2.5
United States	+ 2.2	Apr	+ 1.6	+ 2.3	+ 1.7	+ 2.4	Apr	– 2.1	+ 3.2	May	+ 2.6
Euro area	+ 1.9	May	+ 2.0	+ 1.9	+ 1.5	+ 1.7	Apr	– 0.6	+ 3.4	Q4	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.1	Apr	+ 1.8	na	na	+ 3.1	Apr	– 1.0	+ 4.1	Q1	+ 3.2
Greece	+ 3.8	May	+ 3.4	na	na	+ 1.0	Apr	+ 3.7	na		na
Iceland	+ 2.2	May	+ 5.9	na	na	+ 3.3	Jun	+ 7.4	+ 5.6	Apr	+ 8.0
Ireland	+ 4.3	Apr	+ 4.8	na	na	– 7.5	Apr	+ 0.4	+ 6.8	Q4	+ 7.8
Luxembourg	+ 1.9	May	+ 1.9	na	na	+ 2.8	Mar	– 3.0	– 0.4	Feb	+ 2.5
New Zealand	+ 2.5	Q1	+ 2.6	na	na	– 0.9	Q4	+ 1.8	+ 2.3	Q1	+ 2.1
Norway	+ 2.1	May	+ 0.4	na	na	– 4.5	May	–11.3	+ 5.3	Q1	+ 4.6
Portugal	+ 3.7	Apr	+ 3.6	na	na	+ 2.0	Apr	+ 0.2	+ 1.1	Apr	+ 0.1

*New series.

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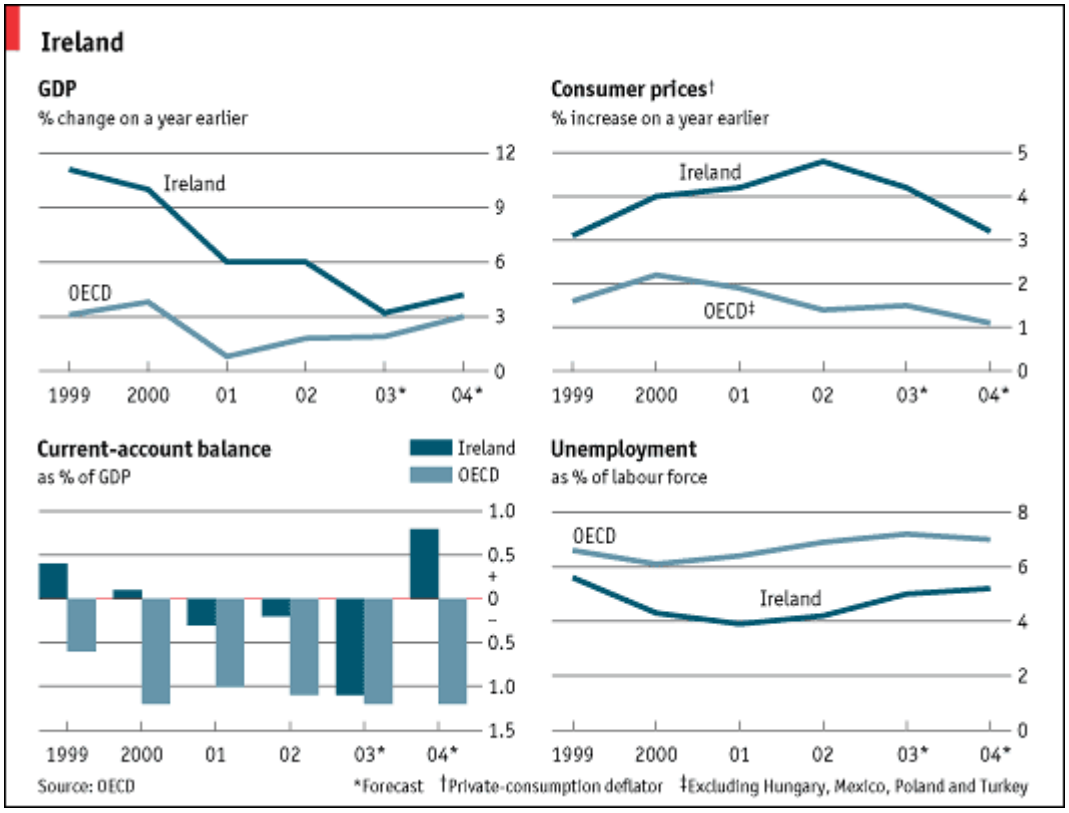
Ireland

Jun 12th 2003
From The Economist print edition



Since the mid-1980s, the Irish economy has grown rapidly, as it became a favoured production base for the European market. American companies, especially information-technology ones, invested heavily in Ireland. During the IT boom of the late 1990s, growth accelerated to over 10% a year. But this pace of expansion proved unsustainable, generating a rise in inflation and wages that undermined the economy's competitiveness. The recent rise in the euro is compounding the problem. Most important of all, Ireland has been severely affected by the collapse of the IT boom. The OECD is now forecasting that GDP growth will slow to just 3.2% this year, before picking up to 4.2% in 2004, mainly because of the stimulus to exports from a recovery in world trade. But it is clear that the Irish growth miracle that turned it into the “Celtic tiger” has now ended.

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Money and interest rates

Jun 12th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jun 11th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.0	+10.8	Apr	4.66	5.02	4.05	4.46	6.10	5.43
Britain	+ 8.6	+ 8.0	Apr	3.63	4.13	3.16	3.91	5.19	5.57
Canada	+ 6.3	+ 5.8	Apr	3.14	2.68	2.94	4.23	5.51	6.21
Denmark	+ 7.4	+ 9.7	Apr	2.30	3.75	2.04	3.69	5.27	5.15
Japan	+ 4.8	+ 1.6	May	0.02	0.02	0.03	0.44	1.34	0.56
Sweden	+ 4.1	+ 4.5	Apr	2.82	4.25	2.78	3.92	5.47	3.20
Switzerland	+27.5	+11.3	Apr	0.27	1.27	0.05	2.08	3.27	2.96
United States	+ 5.3	+ 6.5	Apr	1.08	1.78	1.14	3.19	4.95	5.20
Euro area†	+11.1	+ 8.7	Apr	2.12	3.47	1.91	3.48	5.03	3.54

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.27%, Japan No.250 0.45%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 12th 2003
From The Economist print edition

1995=100

	Jun 3rd	Jun 10th*	% change on one month	% change on one year
Dollar index				
All items	77.0	77.4	+ 0.3	+11.2
Food	77.6	78.6	– 2.0	+13.1
Industrials				
All	76.1	75.9	+ 3.8	+ 8.7
Nfa†	77.1	78.1	+ 5.7	+12.0
Metals	75.2	74.1	+ 2.2	+ 5.9
Sterling index				
All items	74.5	74.1	– 2.1	– 1.2
Euro index				
All items	86.4	87.2	– 1.1	–10.3
Yen index				
All items	97.3	97.0	+13.1	+ 4.2
Gold				
$ per oz	364.75	353.50	+ 0.8	+11.4
West Texas Intermediate				
$ per barrel	30.68	31.66	+10.8	+30.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jun 12th 2003
From The Economist print edition

Market indices

	Jun 11th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,036.9	3,049.6	2,673.3	+ 1.3	-11.7	+ 2.1	+20.2
Austria (ATX)	1,307.7	1,325.7	1,120.2	+ 1.3	-24.7	+13.7	+27.4
Belgium (Bel 20)	1,994.0	2,074.1	1,426.6	+ 1.5	-45.8	- 1.5	+10.3
Britain (FTSE 100)	4,150.1	4,150.8	3,287.0	+ 0.6	-40.1	+ 5.3	+ 9.1
Canada (Toronto Composite)	7,100.8	7,100.8	6,228.6	+ 1.4	-37.7	+ 7.4	+25.3
Denmark (KBX)	188.1	188.1	145.0	+ 3.4	-37.7	+13.2	+26.8
France (SBF 250)	2,103.5	2,144.8	1,630.1	+ 1.9	-52.1	+ 2.4	+14.7
(CAC 40)	3,121.9	3,210.3	2,403.0	+ 1.9	-54.9	+ 1.9	+14.1
Germany (DAX)	3,178.2	3,178.2	2,203.0	+ 3.2	-60.6	+ 9.9	+23.1
Italy (BCI)	1,172.2	1,172.2	959.4	+ 0.7	-46.3	+ 7.4	+20.2
Japan (Nikkei 225)	8,890.3	8,890.3	7,607.9	+ 3.9	-77.2	+ 3.6	+ 4.5
(Topix)	874.7	874.7	770.6	+ 2.8	-69.7	+ 3.7	+ 4.6
Netherlands (AEX)	301.7	337.3	218.4	+ 4.1	-57.0	- 6.5	+ 4.7
Spain (Madrid SE)	708.0	708.0	576.8	+ 2.1	-38.2	+11.7	+25.1
Sweden (Affarsvarlden Gen)	155.2	155.2	127.8	+ 3.1	-61.2	+ 6.9	+20.3
Switzerland (Swiss Market)	4,840.3	4,965.3	3,675.4	+ 1.9	-42.5	+ 4.5	+10.6
United States (DJIA)	9,183.2	9,183.2	7,524.1	+ 1.6	-21.7	+10.1	+10.1
(S&P 500)	997.5	997.5	800.7	+ 1.1	-34.7	+13.4	+13.4
(NASDAQ Comp)	1,646.0	1,646.0	1,271.5	+ 0.7	-67.4	+23.3	+23.3
Europe (FTSE Eurotop 300)*	861.0	890.8	682.7	+ 2.2	-49.5	+ 0.5	+12.5
Euro area (FTSE Ebloc 100)*	737.1	757.2	565.7	+ 2.2	-52.5	+ 2.6	+14.9
World (MSCI)†	892.3	892.3	710.8	+ 1.9	-38.4	na	+12.6
World bond market (Citigroup)‡	580.3	580.3	518.6	+ 1.3	nil	na	+10.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 12th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Jun 11th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Jun 11th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 9.0	Apr	− 20.8	Q1	− 4.3	− 3.6	82.4	78.0	1.51	1.75	2.51	1.77	1.28	0.2
Austria	+ 0.7	Feb	+ 1.4	Mar	− 0.1	− 0.3	102.3§	100.1	0.85	1.06	1.42	–	0.72	-1.3
Belgium	+ 16.4	Mar	+ 11.4	Jan	+ 4.9	+ 5.0	102.2§	98.9	0.85	1.06	1.42	–	0.72	nil
Britain	− 56.8	Apr	− 13.1	Q4	− 1.6	− 1.5	99.5	103.6	0.60	0.68	–	0.70	0.51	-1.9
Canada	+ 36.4	Mar	+ 13.9	Q1	+ 1.6	+ 1.5	86.1	77.9	1.35	1.54	2.26	1.59	1.15	1.1
Denmark	+ 8.7	Mar	+ 5.5	Mar	+ 2.4	+ 2.4	106.9	102.8	6.32	7.86	10.5	7.42	5.37	1.6
France	+ 8.4	Mar	+ 28.6	Mar	+ 1.7	+ 1.5	105.5§	101.5	0.85	1.06	1.42	–	0.72	-3.6
Germany	+124.7	Apr	+ 48.6	Apr	+ 2.0	+ 1.6	102.8§	98.4	0.85	1.06	1.42	–	0.72	-3.7
Italy	+ 6.0	Mar	− 11.5	Mar	− 0.4	− 0.3	75.2§	72.4	0.85	1.06	1.42	–	0.72	-2.4
Japan	+ 95.4	Apr	+111.7	Apr	+ 2.5	+ 2.6	127.7	130.9	118	126	196	138	–	-7.7
Netherlands	+ 28.5	Mar	+ 2.9	Q1	+ 2.9	+ 3.1	101.6§	97.8	0.85	1.06	1.42	–	0.72	-1.6
Spain	− 43.6	Mar	− 18.2	Feb	− 2.2	− 2.2	76.6§	74.2	0.85	1.06	1.42	–	0.72	-0.4
Sweden	+ 15.5	Apr	+ 11.5	Q1	+ 3.6	+ 3.6	81.7	77.1	7.74	9.70	12.9	9.10	6.58	0.7
Switzerland	+ 5.0	Apr	+ 32.0	Q4	+11.7	+11.7	113.1	113.1	1.31	1.56	2.18	1.54	1.11	na
United States	−514.3	Mar	−503.4	Q4	− 5.3	− 5.4	101.6	116.7	–	–	1.67	1.18	0.85	-4.6
Euro area	+ 87.2	Mar	+ 48.0	Mar	+ 0.7	+ 0.6	91.3	81.3	0.85	1.06	1.42	–	0.72	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.3	Mar	+ 9.9	Mar	na	na	81.1§	77.9	0.85	1.06	1.43	–	0.73	3.1
Greece	− 22.8	Mar	− 11.1	Mar	na	na	59.1§	57.5	0.85	1.06	1.43	–	0.73	-1.0
Iceland	+ 0.1	Apr	nil	Q1	na	na	97.7**	86.9	73.7	89.7	123	86.6	62.6	nil
Ireland	+ 36.2	Mar	− 0.2	Q4	na	na	93.4§	87.0	0.85	1.06	1.43	–	0.73	-0.8
Luxembourg	− 3.1	Feb	+ 1.7	Q4	na	na	102.2§	98.9	0.85	1.06	1.43	–	0.73	0.2
New Zealand	− 0.9	Apr	− 1.9	Q4	na	na	96.9	91.5	1.73	2.03	2.89	2.03	1.47	0.8
Norway	+ 27.9	Apr	+ 27.5	Mar	na	na	98.1	104.4	6.99	7.84	11.7	8.22	5.94	11.3
Portugal	− 12.5	Feb	− 8.8	Feb	na	na	92.5**	90.0	0.85	1.06	1.43	–	0.73	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, February average.

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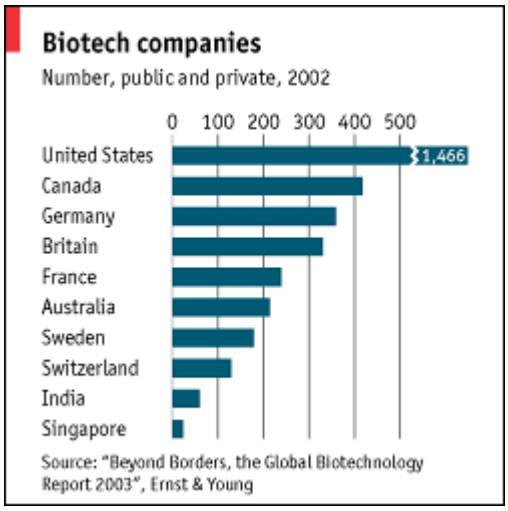
Biotech companies

Jun 12th 2003
From The Economist print edition

America leads the world biotech industry, though developing countries such as India are joining in. There are more than 600 biotech firms in the Asia-Pacific region. But America's quoted companies account for almost three-quarters of global revenues.



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Overview

Jun 12th 2003
From The Economist print edition

Inflation eased in **Brazil** but not by as much as analysts had expected. Consumer prices rose by 0.6% in the month of May, and by 17.2% in the 12 months to May. Industrial output fell by 4.2% in the year to April, the first annual decline in 11 months.

Consumer-price inflation in **Hungary** fell to a 22-year low of 3.6% in the 12 months to May. Industrial output rose by 6.8% in the 12 months to April.

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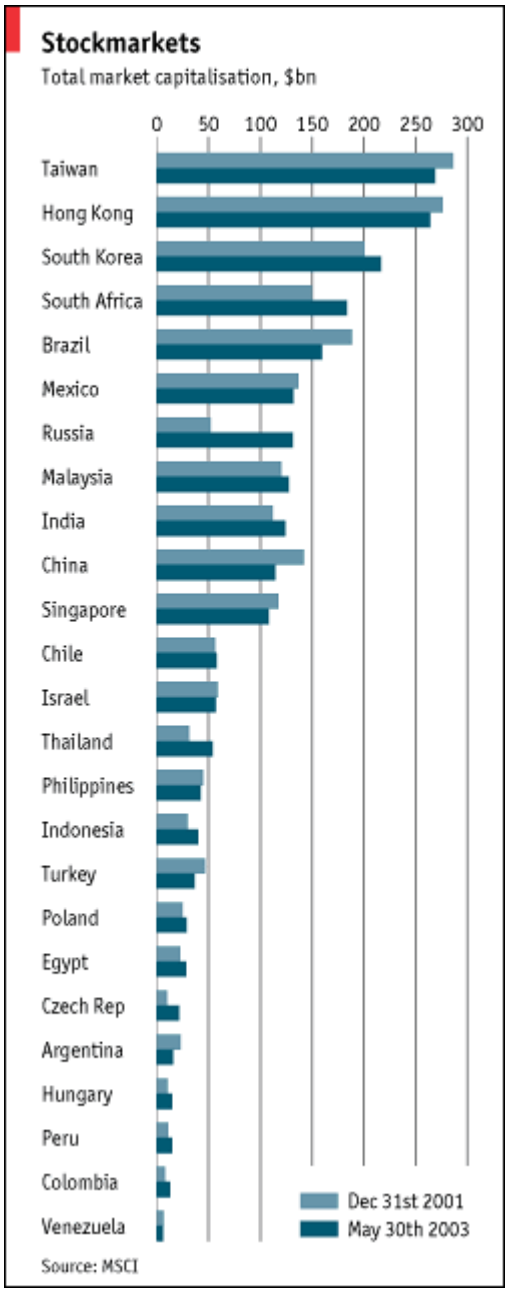
Stockmarkets

Jun 12th 2003
From The Economist print edition

Between the end of 2001 and end-May this year, stockmarkets in emerging economies fell by less than 1%, compared with a decline of nearly 15% for markets in the developed world. Market capitalisations—the value of quoted shares—have risen in several emerging economies. Russia's stockmarket has done particularly well, as investor confidence has returned and the economy has benefited from rising energy prices.



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Economy

Jun 12th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+13.7	May	+ 1.0	Apr	+22.2	May	+35.4	2002	320.9	Mar
Hong Kong	+ 4.5	Q1	– 9.2	Q4	– 1.8	Apr	– 8.0	Apr	+13.8	Q4	116.1	May
India	+ 2.6	Q4	+ 6.0	Mar	+ 5.1	Apr	–10.1	Apr	+ 4.8	Q4	77.9	May
Indonesia	+ 3.4	Q1	+29.2	Feb	+ 6.9	May	+25.5	Apr	+ 7.1	Q3	32.6	Apr
Malaysia	+ 4.0	Q1	+11.8	Apr	+ 1.0	Apr	+15.6	Apr	+ 7.3	Q4	34.4	Apr
Philippines	+ 4.5	Q1	+ 7.3	Mar	+ 2.7	May	– 0.1	Mar	+ 3.1	Feb	12.7	May
Singapore	+ 1.6	Q1	– 5.0	Apr	+ 0.9	Apr	+11.5	Apr	+21.3	Q1	85.8	May
South Korea	+ 3.7	Q1	+ 1.8	Apr	+ 3.2	May	+ 7.6	May	+ 2.6	Apr	123.6	Apr
Taiwan	+ 3.2	Q1	– 0.7	Apr	+ 0.3	May	+16.5	Apr	+25.9	Q1	175.2	May
Thailand	+ 6.1	Q4	+16.2	Apr	+ 1.9	May	+ 4.3	Apr	+ 8.6	Apr	36.8	Mar
Argentina	+ 5.2	Q1	+12.6	Apr	+14.3	May	+16.8	Apr	+ 8.9	Q4	11.0	Apr
Brazil	+ 2.0	Q1	– 4.2	Apr	+17.2	May	+19.3	May	– 3.4	Apr	41.5	Apr
Chile	+ 3.5	Q1	+ 0.6	Apr	+ 3.5	May	+ 2.2	Apr	– 0.6	Q1	15.9	Apr
Colombia	+ 3.8	Q1	+15.3	Mar	+ 7.7	May	– 0.4	Feb	– 1.6	Q4	10.5	Apr
Mexico	+ 2.3	Q1	– 4.8	Apr	+ 4.7	May	– 6.9	Apr	–12.7	Q1	53.7	Apr
Peru	+ 5.2	Mar	+ 5.5	Mar	+ 2.4	May	+ 0.3	Mar	– 1.1	Q4	9.8	Apr
Venezuela	–29.0	Q1	–14.7	Mar	+35.0	May	+15.0	Q1	+ 9.5	Q1	8.4	Feb
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.6	Mar	– 7.4	Jan	+ 0.5	Q4	13.1	Apr
Israel	+ 0.3	Q1	+ 2.9	Mar	+ 3.1	Apr	– 5.8	Apr	– 2.1	Q4	23.7	May
South Africa	+ 2.5	Q1	– 4.9	Apr	+ 8.8	Apr	+ 3.3	Apr	+ 0.3	Q4	6.0	Apr
Turkey	+11.4	Q4	+ 5.6	Mar	+30.7	May	–17.3	Mar	– 3.7	Mar	26.9	Apr
Czech Republic	+ 2.2	Q1	+ 5.6	Apr	0.0	May	– 2.7	Apr	– 4.4	Q1	26.1	May
Hungary	+ 2.7	Q1	+ 6.8	Apr	+ 3.6	May	– 2.5	Mar‡	– 2.5	Mar	10.9	May
Poland	+ 2.1	Q4	+ 8.3	Apr	+ 0.3	Apr	–10.0	Apr	– 5.5	Apr	29.9	Apr
Russia	+ 5.2	Q4	+ 7.1	Apr	+13.6	May	+52.1	Apr	+38.3	Q1	61.1	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.6	May	– 1.5	Apr	+ 2.7	2002†	10.3	Mar
Saudi Arabia	+ 0.7	2002§	na		– 0.9	Jan	+38.6	2002§	+11.7	2002	22.8	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. §Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Jun 12th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 11th		Dec 31st 2002	
	Jun 11th	year ago	Jun 11th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.8	na	1,639.7	−0.5	+ 15.5	+ 15.5
Hong Kong	7.80	7.80	13.0	1.17	9,662.1	−0.0	+ 3.7	+ 3.7
India	46.7	49.0	77.8	4.90	3,314.6	+3.1	− 1.9	+ 0.9
Indonesia	8,232	8,735	13,728	10.86	515.7	+2.2	+ 21.4	+ 32.0
Malaysia	3.80	3.80	6.34	3.10	688.6	+2.3	+ 6.5	+ 6.5
Philippines	53.5	50.4	89.2	7.81	1,168.8	+4.2	+ 14.8	+ 14.6
Singapore	1.73	1.79	2.89	0.56	1,448.8	+3.4	+ 8.0	+ 8.0
South Korea	1,195	1,224	1,993	4.29	651.3	+1.7	+ 3.8	+ 3.0
Taiwan	34.7	34.0	57.8	1.25	4,804.7	+2.7	+ 7.9	+ 8.3
Thailand	41.8	42.3	69.7	1.74	422.6	+2.4	+ 18.5	+ 22.3
Argentina	2.81	3.41	4.69	13.63	736.9	+5.0	+ 40.4	+ 67.9
Brazil	2.88	2.74	4.80	26.27	13,876.5	+1.2	+ 23.1	+ 51.6
Chile	718	667	1,198	2.76	6,105.0	+2.2	+ 21.6	+ 22.0
Colombia	2,813	2,347	4,691	7.76	2,041.2	+3.6	+ 26.9	+ 29.3
Mexico	10.61	9.70	17.7	7.56	6,979.7	+1.3	+ 13.9	+ 12.3
Peru	3.48	3.47	5.81	3.80	1,854.3	+1.4	+ 33.2	+ 34.4
Venezuela	1,598	1,151	2,665	17.14	13,400.4	+6.2	+ 67.2	+ 45.1
Egypt	5.98	4.64	9.97	10.14	7,867.3	−1.7	+ 46.5	+ 13.4
Israel	4.41	4.97	7.35	5.09	422.1	−1.1	+ 27.0	+ 36.8
South Africa	7.9	10.2	13.2	12.75	8,717.3	−0.4	− 6.0	+ 1.7
Turkey	1,425,000	1,553,500	2,376,473	37.00	10,597.3	−4.4	+ 2.2	+ 19.0
Czech Republic	26.6	32.1	44.4	2.31	571.0	+0.5	+ 23.9	+ 40.1
Hungary	219	255	366	7.31	8,008.7	−4.6	+ 2.7	+ 5.2
Poland	3.78	4.01	6.31	5.38	15,437.8	−0.2	+ 7.5	+ 9.0
Russia	30.5	31.4	50.9	18.00	464.8‡	+1.2	+ 23.6	+ 29.5
EMF (MSCI)*	1.00	1.00	1.67	na	325.4	+1.7	na	+ 11.4
EMBI+†	1.00	1.00	1.67	na	280.0	+1.2	na	+ 22.3

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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